D&O and Transactional Insurance 101

Alexandra Roje

Alana McMullin

August 10, 2022

D&O 101: What is insured?

- "Side A" (Insuring Clause 1): First dollar coverage for Ds and Os to the extent the company does not indemnify their losses; no retention/deductible.
- "Side B" (Insuring Clause 2): Coverage for the company to the extent it has indemnified its Ds and Os; subject to a retention/deductible.
- "Side C" (Insuring Clause 3): Coverage for the company and its Ds and Os for Securities Claims.

D&O 101: Key Definitions (the devil's in the definitions)

"Claim" means:

1. a written demand or request for monetary damages or non-monetary or injunctive relief against any of the **Insureds**, or to toll or waive a statute of limitations;

2. a civil, criminal, administrative, investigative or regulatory proceeding initiated against any of the **Insureds**;

3. an arbitration, mediation or other alternative dispute resolution proceeding against any of the **Insureds**;

"Wrongful Act" means:

1. any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, act or omission by:

   a) any of the **Insured Persons** in their capacity as such;

   b) any of the **Insured Persons** while in an **Outside Executive Position** with respect to the coverage afforded under Insuring Clause I.E; or

   c) the **Insured Organization** with respect to the coverage afforded under
   Insuring Clause I.C.; and

2. any matter claimed against any of the **Insured Persons** solely by reason of their serving in such capacity or in an **Outside Executive Position** solely with respect to the coverage afforded under Insuring Clause I.E.

D&O 101: Key Definitions (the devil's in the definitions)

"Loss" means:

1. amounts which an **Insured** is legally obligated to pay as a result of a **Claim** or **Investigation** including compensatory damages, judgments (including prejudgment and post judgment interest awarded against an **Insured** on that part of any judgment paid by Underwriters), settlements, verdicts, awards, statutory attorney fees, **Defense Costs** and punitive, exemplary and multiple damages where insurable by law in the applicable jurisdiction most favoring coverage for punitive, exemplary or multiple damages;

2. **Inquiry Costs** as a result of an **Inquiry**; and

3. **Books and Records Costs** a result of a **Books and Records Demand**.

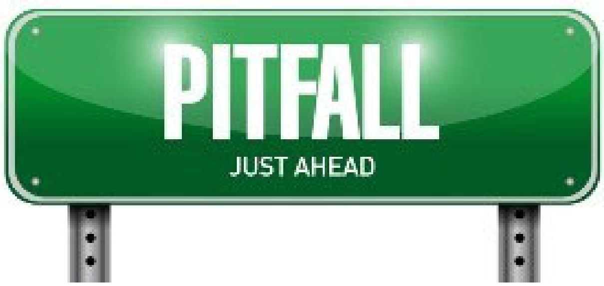
Check-In

D&O 101: Common exclusions

- Outside capacity wrongful acts
- Fines & penalties
- Inadequate consideration (“bump up”)
- Public policy
- Prior or pending claims
- Personal or bodily injury
- Professional services

D&O 101: Avoiding pitfalls

- Get coverage counsel involved if there is any coverage issue, no matter how minor.
- When in doubt, disclose.
- Don't be afraid to give notice, and don't wait.
- Develop a process for submitting legal bills.
- Keep lines of communication open.
- If the policy will not be renewed, give notice of circumstances before expiration.
- If time is of the essence, seek an agreement from the insurer to waive lack of consent as a defense to settlement.



Transactional Insurance 101: What is it?

- Facilitates mergers, acquisitions, divestitures and other business transactions, especially in an auction process.
- Provides access to the insurance industry's capital; transfers certain transaction-related risks to the insurance markets.
- Common examples:
  - Representations & Warranties Insurance
  - Tax Liability Insurance
  - Contingent Liability Insurance
  - Environmental Risk Insurance
  - Successor Liability Insurance

Transactional Insurance 101: Why do I need it?

Answer:
To facilitate business transactions when traditional solutions are impractical.

Due Diligence

Risk Assessment

Traditional Solution

Additional Due Diligence
Additional Representations and Warranties
Broader Indemnities & Larger Escrows
Purchase Price Adjustments
Other Contractual Arrangements

Insurance Solution

Transactional Insurance

Transactional Insurance 101: Why do I need it? (cont'd)

Buyers	Sellers
Risk Management Uses	
• Increase maximum indemnity/extend survival period for breaches of reps & warranties	• Reduce contingent liabilities
• Ease collection concerns	• Distribute sale proceeds
• Manage jurisdictional issues	• Protect passive sellers
• Prove recourse when no seller indemnity possible (e.g., bankruptcy)	
• Satisfy lenders' requirements for additional security on transactions	
Strategic uses	
• Distinguish bid in auction	• Attract best offers; maximize indemnification
• Protect key relationships	• Insurance as sole remedy in auction drafts

RWI 101: What's insured?

Buy-side policies

- Insurance replaces sellers' potential indemnification liabilities under acquisition agreement
- Covers loss resulting from alleged breaches buyers discover or third parties assert during the policy term
- Can enhance indemnification terms set out in acquisition agreement via extended survival periods and/or an increased cap
- Covers fraud by the sellers

Sell-side policies

- Sellers backstop their potential indemnification liabilities agreed to in acquisition agreement
- Liability policy structure – covers claims made against sellers alleging breaches (actual losses and defense costs)
- Mirrors indemnification terms set out in acquisition agreement
- Knowledge between sponsors and management sellers can be severed
- Typically excludes fraud by sellers

RWI 101: What’s insured? (cont’d)

- Protects against financial losses resulting from inaccuracies in the representations and warranties relating to the target company or selling shareholders.
- First party vs. Third party claims.
- Capacity to insure limits from $1 million to $500 million+ subject to capability.
- Policy period typically 6 years for fundamental and tax representations, and 3 years for other representations (regardless of survival period in underlying agreement).
- Retention can drop down as the escrow released (usually at 12 or 18 months).
- Materiality scrape and pre-closing tax indemnity in underlying deal typically matched.

RWI 101: What isn't insured?

- Forward-looking statements and projections.
- Breaches that occur between signing and closing.
  - Insurers will cover breaches discovered from sign to close arising from matters existing prior to signing (i.e., matters the insurers can diligence), but not breaches both first arising and discovered between sign and close ("interim breaches" in most policies).
- Multiplied damages?
- Items identified as high risk in diligence and deal-specific underwriting concerns.
- Known or scheduled matters.
- Known breaches (may be addressed via a separate contingency policy).
- Deferred tax assets, underfunded benefit plans, wage and hour claims, environmental risks.

Check-In

RWI 101: The underwriting process

Step 1: Negotiate and execute NDA (counsel/broker)

Step 2: Provide submission to prospective insurers (through broker)

- Requested information includes draft agreement, financial information, offering memo.

Step 3: Obtain quote within 2-5 days (through broker)

- No charge to obtain quote.
- Quote process will inform prospective insured of the market's appetite to insure deal (and the market's concern regarding certain risk areas, which will be excluded in the quote, or subject to heightened scrutiny in the carrier's underwriting process).

RWI 101: The underwriting process (cont’d)

Step 4: Select carrier and pay underwriting fee (client)
- Fees range from $30k-$50k depending on the nature of the risk.
- Insurers will often share own report with excess carriers for an additional $5k per carrier.

Step 5: Underwriting process for 5-10 days (team)
- High level review of due diligence (if buyer-side) or disclosure process (if sell-side).
- Access to legal, financial, tax, other DD reports (if buyer-side).
- Conference call(s) and follow-up email questions with deal team.

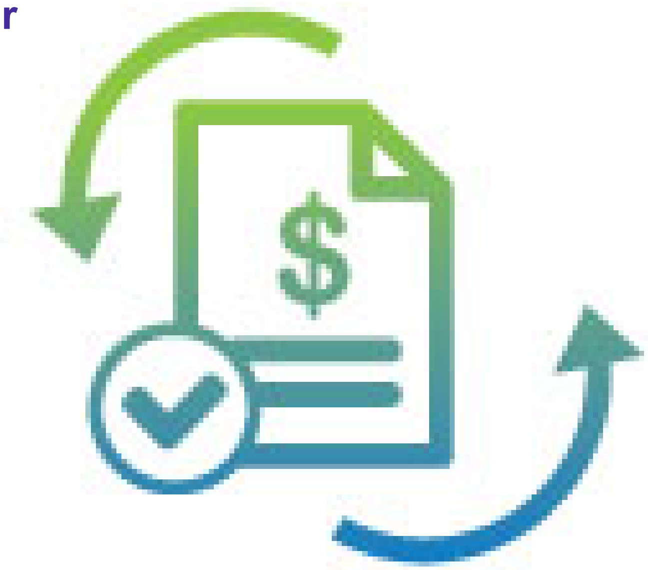
Step 6: Policy wording negotiations (counsel/broker)
- Will often be concurrent with underwriting process.
- Work closely with outside counsel.

RWI 101: The claim process

- Investigation
  - Review the Purchase Agreement and identify the breach.
  - Review the policy.
  - Identify subject matter experts and counsel.
  - Collect back up documentation.
  - Quantify damages.
- Notice to insurers
  - Make sure notice complies with policy requirements.
  - Prepare notice based on information obtained to date even if not complete.
  - Include communications with sellers and status of indemnity claim.

RWI 101: The claim process (cont'd)

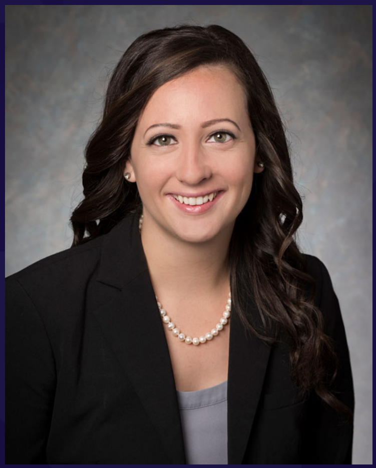
- Insurer review
  - Claims works closely with the underwriter who is familiar with the deal and the policy
  - Is there a breach?
  - Exclusions?
  - Does Loss flow from the breach?
  - Are multiplied damages appropriate?
  - Differences in first vs. third party claims.
  - Use of outside counsel and experts.
- Communication and negotiation
  - Communications before written analysis
  - Review ROR letter and provide additional information
  - Prepare detailed proof of loss
  - Parallel track with seller to resolve escrow issue



THANK YOU

Please feel free to contact us:

Alexandra Roje
Partner, Insurance Recovery & Counseling
310.789.4661
Alex.Roje@lathropgpm.com



Alana McMullin
Associate, Insurance Recovery & Counseling
816.460.5531
Alana.McMullin@lathropgpm.com