

COVID-19: IMPACT ON REPRESENTATIONS AND WARRANTIES INSURANCE

How does COVID-19 impact representations and warranties coverage and the associated underwriting process?

Generally speaking, insurance carriers have started including exclusionary language in every policy and noting it on every proposal. Certain carriers are attempting to take a more commercial, case-by-case approach when considering exclusionary policy language for COVID-19, even tailoring language for each specific transaction. A few industries that are particularly concerning to underwriters are as follows:

- Hospitality
- Healthcare
- Retail
- Entertainment
- Public transportation
- Global supply-chain dependent businesses

This exclusionary language will continue to evolve, but it is safe to say that carriers' views of both direct and consequential impacts of COVID-19 will be conservative, regardless of industry. Further, underwriters are understandably looking carefully at any re-drafting in merger agreements and responding accordingly with appropriate policy language.

Coverage and Exclusions

As noted, carriers are working through varying degrees of exclusionary language. Limiting these exclusions to various extents is often possible depending on the target industry and the representation and warranty language in the purchase agreement.

Example:

Generally limiting exclusionary language to losses directly arising from (as opposed to relating to) negative business impact arising out of COVID-19 could increase the responsibility of the insurer to show losses were directly caused by COVID-19.

Some carriers are willing to apply exclusions on a proportionate basis, only to the percentage of the loss deemed to be arising from COVID-19. Additionally, some carriers are willing to limit exclusions to specific representations and warranties. Given that COVID-19 is a known risk, however, carriers are expected to maintain a relatively strict approach to coverage. In the absence of underlying corporate insurance protection for COVID-19 losses, parties should consider using additional or special indemnities to mitigate this risk.

Due Diligence

Buyers' due diligence (and carriers' review) of target businesses is becoming increasingly focused on insurance coverage, emergency preparedness, IT systems (including remote working arrangements), privacy, and other business continuity measures. Additionally, there is a clear focus on customer concentrations with exposure to COVID-19 and targets' abilities to perform under existing contracts.

How does COVID-19 impact the mergers and acquisition process and negotiations?

Within certain highly effected industries, unless a deal has been signed or largely negotiated, transactions are pausing for COVID-19 impact analysis; inversely, new transactions in industries such as healthcare, technology, food distribution, and subscription-based models are being initiated and closed. Deal timing has appeared to slow due to renewed negotiations with financing sources in addition to buyers' inability to travel and make site visits.

Representations and Warranties

Buyers are requesting additional representations and warranties from sellers relating to the potential impact of COVID-19. Standard negotiations over materiality and knowledge qualifiers around these issues are likely.

Sellers may attempt to ringfence or alternatively assign proportionate loss language to representations and warranties related to the effects of COVID-19 to minimize a buyer's post-closing claim that the outbreak resulted in a breach of more general representations and warranties.

Material Adverse Effect (MAE)

Depending on varying deal dynamics, it is expected that more sellers will endeavor to require a disease outbreak or similar carve-out in MAE definitions, arguing that COVID-19 is a known problem that buyers can diligence before signing a purchase agreement. For at least the foreseeable future, buyers will likely contend the opposite – that the long-term impact of COVID-19 and the possibility of other similar outbreaks remains unknown. Therefore, if there is a long period between signing and closing, buyers will likely argue their need to analyze and respond to the ongoing and evolving impact of COVID-19 during the interim period.

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