Aon Risk Solutions
Global Construction and Infrastructure

Discovering the Value Representations & Warranties Insurance Can Bring to P3 Transactions and Other Construction Projects

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Empower Results®

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In today's competitive marketplace delivering the greatest value means more than just the lowest bid. It means offering solutions which can overcome issues in finalizing deals, reduce the buyers' risks in acquiring assets, add value to buyers' offers in competitive bidding settings, and reduce the sellers' risks of paying post-closing indemnification claims. Representation and Warranties (R&W) insurance addresses each of these needs and can be customized to the specifics of each deal. While use of R&W insurance is widely accepted on mergers and acquisitions deals, the use of this coverage for P3 and other construction projects has been minimal. The question then becomes how can this coverage be customized to deliver value to the infrastructure and construction industry?

Overview of R&W Insurance

R&W insurance protects the insured from losses resulting from unintentional and unknown breaches of the representations and warranties contained in the purchase agreement and is used to supplement or replace a seller's general indemnity and escrow obligation. This claims-made coverage is tailored to the specifics of the deal unlike traditional property and casualty-based coverage (P&C coverage) which typically utilizes standardized terms and conditions. Some of the terms and conditions that can be customized include coverage, policy duration, limits, and other relevant considerations. However, like P&C coverage, the policies will have deductibles, limits, and exclusions. In the U.S. market, the deductibles typically range from 1% – 2% of the policy limit, and policy limits can vary from $5 million up to $1 billion. Pricing is dependent upon the limits purchased and usually ranges between 2.5% and 4% of the overall limits.

R&W insurance can be purchased by either the buyer or the seller depending on the purpose for which it is being procured. Buy-side policies cover the buyer for breaches of seller's R&Ws and sell-side policies back-stop the seller's indemnification obligations for claims made by buyer against them for breaches of their R&Ws. Globally, the majority of the policies purchased are buy-side policies because it is a more efficient use of capital.

Advantages That Reps & Warranties Insurance Offers

- Risk Shifting: Shifts potential unknown and unintentional liabilities for breaches of representations and warranties to the R&W insurance.
- Reduction or Elimination of Indemnification Obligation/Escrow: Allows seller to receive a greater percentage of sale proceeds at closing, which buyer can potentially use to negotiate a reduction to the purchase price.
- Broadened Indemnification Protection: Buyer can obtain coverage with extended survival periods (typically three years for general R&Ws and six years for tax and fundamental R&Ws) and larger amounts of protection (policy limits are typically 10-20% of the purchase price but can be up to 100% of purchase price).
- Reduction of Credit Risk: Buyer collects from a neutral third party insurer with a strong credit rating that is experienced in the claims payment process. If the seller is a foreign entity or at risk of insolvency, R&W insurance protects against having to pursue actions through the international courts or through bankruptcy court.
- Avoidance of Conflicts with Senior Management: Often times the senior management of a company being acquired is involved in the negotiations of the acquisition. If there is a dispute over certain representations or warranties, this could lead to conflict within the new organization.

How R&W Insurance Can Be Used By Infrastructure and What Types of Deals Benefit

R&W insurance is often coupled with references to mergers and acquisitions, which is a rather broad category and can lead infrastructure and construction companies to believe that the coverage is not right for their P3 or other construction projects. However, R&W insurance has the potential to be used in a variety of business transactions. The typical transaction using R&W insurance is valued between $30M and $3B. Most secondary market P3 projects and a large number of other construction projects being acquired can easily satisfy this value. Most P3 projects fit the requisite transaction value. For P3 projects, an optimal time would be when the contractors or private equity firms eventually look to sell the leasehold interests to a third-party. While other types of construction and infrastructure projects do not have a leasehold aspect to them, there may still be opportunities for the use of R&W insurance. Real estate contractors and developers could find value in the post-construction sale of the assets that they own.

R&W insurance is gaining greater acceptance in the energy and real estate sectors which have similar risk profiles to large infrastructure projects. Given the customized nature of R&W insurance, it would be a matter of collaborating with the underwriting community to outline the risks to be addressed, the limits to which those risks can be addressed by the R&W policy and the costs associated with insuring those risks.

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If you have questions about your coverage or are interested in obtaining coverage, please contact your Aon broker.

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