

WHAT IS LITIGATION INSURANCE? HOW CAN IT ADD VALUE?

The impact of litigation against a company can be tremendous, both in terms of expenses involved and its effect on a company's reputation. Even where a potential adverse outcome is considered remote, the outcome of such litigation can significantly reduce a company's perceived value.

In a sale purchase, restructuring or refinancing transaction, disclosure and due diligence may identify a potential litigation which, although remote, could cause a prospective buyer or financier to re-evaluate the transaction. In order to take



the transaction forward the buyer or financing bank may require that either part of the consideration is placed in escrow or an adjustment is made to the consideration or loan facility. This may impact the value or overall viability of the deal.

Litigation insurance can be a useful tool to provide ring-fenced third party security for the contingent litigation risk, thus enabling the transaction to move forward. It is a bespoke policy put in place with the specific objective of covering the adverse outcome of a potential litigation, including damages, awards and/or settlements along with the defence costs that may be incurred by the insured party in connection with the resolution of the litigation.

The litigation may be perceived as a remote risk (i.e. where a notification was made from a claimant some time ago but no proceedings have been issued), or can be more advanced in the claims process, for example, where the risk relates to an adverse outcome from appeal.

Typically, for cases in which insurance is structured the risk is remote but the quantum of an adverse outcome is significant and can represent a major percentage or even exceed of the value of the target. Policies can be structured to transfer the entire financial risk or, as is typically the case in more advanced litigation, arranged as a 'cap' excess of a certain assessed level of risk outcome or self-insured level, thus offering 'worst case' coverage.

Whilst generally negotiated in conjunction with a transaction, coverage can be arranged as a commercial or strategic objective for clients wishing to transfer a litigation risk that could impinge on a business's ongoing balance sheet.

WHEN SHOULD YOU INVOLVE WILLIS AND HOW LONG DOES IT TAKE TO ARRANGE A POLICY?

The process of arranging litigation insurance typically takes a minimum of two weeks and consists of the following stages:

Feasibility: Our experts can make an initial assessment of feasibility through discussions. However, in order to obtain indications of appetite for the risk and to provide any guidance on premium levels from underwriters, the policy negotiation process involves providing the following:

- an overview of the litigation risk;
- copies of any advice (legal) provided by the clients' advisers on the risk;
- copies of any other documentation relevant to the risk including pleadings and rebuttals; and
- a conference call with the client and/or their advisers to answer any queries.

Indication: Insurers will then offer an indication of terms including premium and any requests for further information. This indication will be subject to the insurers' own due diligence review.

Insurers Underwriting Diligence: Insurers will appoint their own advisers to conduct an underwriting diligence review in order to assess the risk. At this stage, more extensive documentation may be required by the insurers.

Policy Negotiation: As each litigation risk is individual in nature, the policy wording for each project is specifically adapted. Willis' knowledge, expertise and experience in such negotiations is central during such discussion.

Completion: Once the policy wording negotiations are settled, the client can accept the offer from insurers. Cover will be incepted subject to insurers being in receipt of the premium.

HOW MUCH DOES IT COST?

It is difficult to provide accurate guidance on premium levels without knowing the details of the litigation risk. Unlike other transaction insurances where a more generic premium range is applicable, every litigation risk is viewed on its specific circumstances. Insurers' evaluations will vary depending upon the complexity of those circumstances and the likelihood of a litigation process being commenced.

In our experience, if the risk is insurable the rate (which is applied to the aggregate policy limit) varies between 4-8%. In addition, the insurers may instruct external advisers for their underwriting due diligence. For a more accurate assessment of the current market position, please contact us.

CASE STUDY

Recently we were involved in placing litigation insurance for a multi-jurisdictional sale purchase transaction which was supported by financing banks. A potential risk was identified in relation to the target company that had been involved in a restructuring process in the past, and a theoretical risk relating to a previous sale of the shares. Whilst the buyers assessment considered the risk to be low, the financing banks were unable to proceed with the transaction without a provision and security for such risk. The risk quantum was estimated to be high and setting funds aside in an escrow was not a viable option for either the seller or the buyer. As the seller and the target company had a presence in different jurisdictions, the nature of the risk was quite complex.

In order to progress the transaction, the buyer approached the Willis team to obtain an opinion on the insurability of the risk. Upon a review of the transaction documents we were able to identify the main areas of risk and the best ways for the insurer to obtain comfort on the areas of concern. We were able to successfully present the risk to the insurers and negotiate a bespoke policy that fulfilled the client's requirements and provided the necessary security to the banks.

For more information contact your local Willis Associate, or call the London M&A Practice on +44 (0)20 3124 6000.

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