INTRODUCTION

Our latest intelligence monitor shows a surge in complex tax enquiries, reflecting the M&A market's appetite for innovative risk transfer options amid a tightened regulatory environment. This edition further highlights simplified solutions for Directors and Officers cover, and confronts the challenge prospective buyers face when their intended target has negative equity.

Willis has been leading development with the provision of risk profiling, managing risk mitigation and consulting on the important contract dynamics working with investors and management teams on ground breaking transactions in CEE, China, Latin America and MENA regions.

Operationally, Simon Dodsworth and Brian Hendry have assumed responsibility for the delivery of the International M&A Practice, whilst the continued support of Sebastiano Doria, Alistair Lester and Richard Worker is developing our client relationships throughout the world.

SAVE THE DATE

Capital Creation 2011 will return to Le Meridien Beach Plaza in magnificent Monte Carlo from the September 26 – 28. Paul Search, Executive Director Risk & Analytics, Willis will be speaking at the event with other panel members on Value Creation: Understanding value, mitigating risk and optimising returns.

Details of the event can be found here: http://www.wbresearch.com/capitalcreationeurope/

Booking for the event is now open and we look forward to seeing many of our friends in Monte Carlo. When booking please use our preferential client discount code TSL/AD to receive 10% off.
Over the course of recent years, a market has developed for the insurance of complex tax risk. The insurers involved include a combination of Lloyds Syndicates and various commercial insurance companies. The origin of the market is in the context of corporate mergers and acquisitions. Historically, where a target company had a pre-existing dispute with the local tax authority, or where the purchaser’s advisers identified a possible challenge, the vendor was obliged to indemnify the purchaser against the risk of tax falling due, if necessary supported by money on escrow or bank guarantee. To allow the vendor a clean break, as well as to avoid cost and complexity, insurance against the risk became an alternative solution. For a premium, the insurer would offer a policy to the purchaser or the target, under which he would be compensated should the potential tax exposure arise.

In offering this kind of cover, initially against relatively straightforward risks, insurers have developed an appreciation of the exposures that can arise in the context of corporate taxation, where the legal analysis of a particular position is often not certain. Consequently, over time, insurers have expanded the circumstances under which they can offer tax risk cover beyond M&A. Although always fact and circumstance specific, insurers will now consider providing cover against tax risk on any individual transaction or line of transactions entered into by a bank or large corporate.

Willis has recruited a team of Structured Finance professionals with investment banking and tax legal backgrounds, whose role includes facilitating the insurance of complex tax risks. Working in conjunction with our insurance brokers, the team can generally quickly identify those risks which are appropriate for insurance. The team are also familiar with individual insurers’ risk appetite, and can describe the risk to insurers accurately and identify its advantages and disadvantages. This enables our clients to receive a rapid decision from the insurers in principle as to whether the risk can be covered.

The team also have experience of the commercial issues that a bank or large corporate must address in contemplating insurance of complex tax risks. As they, with our insurance brokers, also have an appreciation of the commercial requirements of the insurers, we are well placed to ensure that the approach to negotiations in respect of a policy by both the insurer and insured is conducted in a realistic and efficient manner.

Andrew Garston joined Willis from the Structured Finance Department at Commerzbank and prior to that Swiss Re. Previously, having completed his studies, he worked as a tax qualified chartered accountant at KPMG and Deloitte.

Fiona Houston is a qualified tax lawyer having previously worked at Linklaters for seven years.
DARCSTAR: NOT YOUR CONVENTIONAL D&O COVER

Willis has recently launched Willis Directors’ All Risk Cover (DARCSTAR), a revolutionary approach to Directors & Officers’ insurance, designed to simplify the protection available to directors and officers in the event of a claim.

DARCSTAR moves away from the complexities of indemnifiable and non-indemnifiable losses. In just eight pages, it delivers broad and relevant cover in an easy to understand policy.

THE CONVENTIONAL DILEMMA: INSURANCE VS INDEMNIFICATION

- When a company buys D&O cover, insurers expect and routinely require companies to indemnify their directors wherever possible before insurers’ obligation to pay is triggered. The potential for a dispute on this issue between insurers and insured is ever present.
- In practice, this means that directors and officers may be left without cover while insurers and companies dispute whether a particular loss is indemnifiable.
- Of particular concern is the fact that a gap in cover can arise where a company may be legally permitted to indemnify but chooses not to do so. Much depends on the particular way in which a policy defines the concept of ‘indemnifiable loss’ (often in the small print).
...this is how many conventional D&O policies operate.

The issue is particularly pertinent for non-executive directors, who can get caught between interpretations over the fine print about whether there is indemnification or not, and whether the company will fund defence costs.

DARCSTAR is a groundbreaking development in D&O and the most significant shift in coverage for many years. Designed to promote more transparent claims handling and to provide our clients with a clearer understanding of the insurance they are buying, DARCSTAR offers a genuine alternative to conventional D&O policies.
Can Warranty Insurance Give Buyers Protection When The Target Has Negative Equity?

When the management or equity holders of a target may potentially receive no value from the sale of the business, it is unlikely that they will be willing to assume financial risk under warranties in the sale agreement. Buyers however, will typically require a minimum level of warranty protection from sellers.

Can Warranty Insurance Be Structured to Provide a Solution?

Warranty Insurance can provide an effective solution, provided that:

(i) The scope of the warranties are negotiated;
(ii) A thorough disclosure and due diligence exercise is conducted;
(iii) There is some financial risk that can be capped at a very low quantum.

In general, most insurers look to attach an insurance policy at a minimum of 1% (Europe) – 2% (U.S.) of enterprise value (the policy attachment or excess). However, the level of uninsured risk can be shared by both seller and buyer. In certain cases, some insurers can be flexible on the level, but this is heavily dependent on whether the parties with knowledge of the business are motivated and involved in the disclosure/due diligence process. For example, we have been involved in transactions where:

- Sellers agreed a management bonus on the successful sale of the business, provided the management gave warranties capped at 50% of their bonus (equivalent of 0.5% of deal value). The buyer then took out a warranty cover attaching above 1% of deal value.

- Financial Stakeholders gave warranties for 12 months capped at 1% of deal value which was held in escrow. They relied on a disclosure exercise conducted by management who were staying with the business and taking an equity stake in the buying entity. The buying entity then took out warranty cover attaching above 1% of deal value and extended to six years for tax.

- A Private Equity Fund at the end of its life owned a Holding Company (the seller) whom gave warranties in relation to a disposal of two subsidiary target companies. In each transaction the seller capped the warranty exposure at 1% of deal value, reducing to 0.5% after year one to year three. The buyers purchased warranty insurance coverage above 1% of deal value and dropping to 0.5% after year one and extending to six years for tax. This enabled the majority of the funds to be distributed and the holding company to be wound up after the expiry of the warranties.

Some Key Factors to Consider Include:

It is vital that if a structure is proposed with low warrantor risk, the insurers are not approached with a draft one buy-side warranty ‘wish list’ of warranties. If insurers are:

- given a full understanding of how the parties are motivated to conduct a disclosure process (even if they have minimal financial risk);
- given a reasonable set of warranties, and;
- are satisfied with the thoroughness of the due diligence exercise;

they are more likely to accommodate a structure which successfully provides the necessary protection at competitive terms. Insurers will want access to the buyers’ due diligence and will typically exclude issues highlighted in such reports that would give rise to a breach of warranty when the warranties are given. The insurers’ view is that these matters should be negotiated in the price or considered separately (in certain cases, cover may be available but will be underwritten separately dependent on the nature of such issues).

Adding Value

In the current market, there are a large number of companies who, despite having reasonable EBITDA and assets, are encumbered by debt which is resulting in negative equity. This has resulted in the shareholders having little or no value and the debt providers effectively taking control. At some point, the banks will need to decide how to manage their exposure. If they can minimise ‘write-offs’ or reduce their exposure through a sale, the target company and management can move on with a new shareholding and financing structure. However, the transaction value and interest from buyers can be hampered by the lack of warranty comfort – buyers warranty insurance, if structured in conjunction with the interested parties, can benefit and add value to both the selling stakeholders and the buyer.
**RECENT ADDITIONS TO THE TEAM**

**JOANNE FOLEY, ACII**  
Divisional Director

Joanne graduated from the University of Limerick having completed her degree in Insurance and European Studies in 1998. After working for Aon and Marsh in Dublin, Joanne moved to London in 2003 to develop her career in the London market, which provided access to more sophisticated insurance programme structures and global programme management opportunities.

Joining Willis in 2004, Joanne became heavily involved in the PPP/PFI sector, acting as Lead Project Risk Consultant in Willis London focusing on delivering contractor/SPV side tender support to a wide variety of clients.

Since joining the M&A team in March 2010, Joanne has drawn on her general insurance knowledge, contractual risk management and analytical skills, working on over 30 deals during that time.

**PATRICIA PAKULSKA**  
Junior Project Manager

Patricia Pakulska has been with the M&A Practice as Junior Project Manager since January 2011. Patricia graduated in July 2010 with a 2:1 in Law from Exeter University.

Patricia is training to specialise in the analysis of SPA contracts, and the development of key documents used in Merger and Acquisition negotiations where Warranty and Indemnity Insurance is being arranged. She will also be taking part in upcoming marketing projects in 2011.

**EMILY HOLLOWAY**  
Business Development Executive/Account Executive

Emily Holloway recently joined the FINEX National London team as a Business Development Executive/Account Executive.

Emily has spent over seven years in the insurance industry, and the last five years specialising in financial institutions and focusing on insurance solutions for the alternative asset sector.

Prior to joining Willis Emily worked at Windsor Partners, where she was responsible for targeting and converting new business across all financial institutions, with particular experience in the private equity and investment sector and, geographically, the U.K. and Channel Islands. Emily also worked at Howden where she was Head of Offshore Funds and was instrumental in developing and growing their client base.

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RECENT WILLIS SUCCESSES/TOMBSTONES

Willis Mergers & Acquisitions Practice provided Insurance Due Diligence Advisory Services on the Investment in Regasificadora del Noroeste by First State Investments

January 2011
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice provided Insurance Due Diligence Advisory Services on the Acquisition of AIRCOM INTERNATIONAL by H.I.G. Europe

February 2011
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice provided Insurance Due Diligence Advisory Services on the Acquisition of Butterfield Fulcrum Group and FORS Limited by BV Investment Partners

April 2011
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed the Insurance Due Diligence for the €425 million Acquisition of TP Emitel by Aitcom

June 2011
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice performed the Insurance Due Diligence for the €425 million Acquisition of TP Emitel by Infracapital

June 2011
This announcement appears as a matter of record only

Willis Mergers & Acquisitions Practice

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