ETHOS SPECIALTY

# Representations & Warranties Bankruptcy Insurance

In the context of a distressed or bankruptcy sale, representations and warranties insurance has a number of benefits, especially to the Buyer, but also to the Seller/Debtor or Creditor. Challenges also exist for distressed and Bankruptcy Court approved Section 363 Sales.

## ABOUT SECTION 363 SALES

A 363 Sale refers to the sale of a Debtor's assets pursuant to Section 363 of the US Bankruptcy Code. Such a Sale enables the Debtor to fulfill its obligations to its Creditors by selling its assets and using the proceeds to settle its debts.

Similar to a non-bankruptcy transaction, in a 363 Sale process, the Debtor will broadly market its assets. Upon receipt of bids for such assets, the Debtor then will select the best bidder to be the "Stalking Horse." After selection, the Debtor and the Stalking Horse will fully negotiate and execute a purchase agreement. At that point, the Debtor will file a motion with the Bankruptcy Court seeking approval of the sale at a bankruptcy auction. Upon approval, the Debtor will notify its Creditors and other potential bidders who then may make a bid and enter the auction. The Debtor then will select the best bid at auction. Upon completion of the auction, the Debtor will seek the Bankruptcy Court's approval to sell to the winning bidder.

## R&W INSURANCE IN A 363 SALE

Offering a R&W Policy in a 363 Sale would likely create certain additional benefits to the traditional 363 Sale process including:

- The Buyer would be able to seek recourse against a R&W Policy in the event of a breach of any Debtor representation or warranty that results in loss to the Buyer. In contrast, in a traditional 363 Sale, the Buyer typically is left with limited recourse, if any.
- The inclusion of such a remedy for the Buyer, likely would embolden the Buyer (and other potential bidders) resulting in better and higher bids and increased proceeds to the Creditors of the Debtor.
- The ability to seek recourse in the event of a breach and increased proceeds, may provide an opportunity for bidders to seek broader representations and warranties that they would have in a traditional 363 Sale. It should be noted that a Bankruptcy Court may view an over-expansion of representations and warranties unfavorably (as a deterrent to the sale process).


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**Traditionally, some of the benefits of the 363 Sale process are:**

- Upon completion, it ensures the Debtor has fulfilled its fiduciary duty to maximize the value of the assets for its Creditors.
- The Buyer acquires the assets free and clear of liens or other claims and obtains certain other protections including a determination that the sale was in good faith.
- Often, the Buyer is able to purchase the assets at a discount.

## THE ETHOS UNDERWRITING PROCESS FOR 363 SALES

The underwriting process in a 363 Sale would largely mirror the underwriting process in a non-bankruptcy transaction and would be reliant on fulsome diligence conducted by the Buyer as well as the Buyer's forthright participation in an underwriting call and related communication. This process can usually be completed in 7-10 days, but, in certain instances, can be performed on an expedited timeline.

**In contrast to a non-bankruptcy sale process, underwriters in a 363 Sale process would likely focus more heavily on pertinent factors including:**

- the availability of the Debtor's management throughout the Buyer's diligence process
- the continuity of management after Closing;
- the financial health of the Debtor prior to the COVID-19 outbreak.

Although alternative timelines for underwriting in a 363 Sale process may be available, it seems most practical that the underwriting process likely would begin upon a Stalking Horse being selected by the Debtor. At that point, the underwriter could be engaged on a pre-exclusive basis to underwrite the transaction as the Debtor and Stalking Horse prepare for the bankruptcy auction. This would allow for the parties to be ready to bind coverage in conjunction with the execution of the Transaction Agreement at the conclusion of the bankruptcy auction.

Even though the Bankruptcy Court's ruling would ultimately preside, we would expect that the Stalking Horse's pre- exclusivity fee would be reimbursed as part of its break-up fee in the event the Stalking Horse were is not selected as the winning bidder in the bankruptcy auction.

## COVERAGE

Although the coverage offered in a R&W Policy for in a 363 Sale would closely resemble that of a R&W Policy for a non-bankruptcy sale, Buyers should expect potential increases in underwriting fees, premium or retention (which likely would be borne entirely by the Buyer) to address potential complications in underwriting associated with the bankruptcy process and to account for the Insurers lack of subrogation rights (similar to the Buyer's lack of recourse in a traditional 363 Sale).

## ABOUT ETHOS

Ethos Specialty is a leading Managing General Underwriter (MGU) that develops industry-specific insurance programs and provides specialized underwriting services on behalf of high-quality carrier and syndicate partners. Ethos has developed, and is the underwriting manager for, multiple niche-programs across Property, Casualty and Transactional Liability Insurance.