

Transactional Insurance for Healthcare Deals



27th June 2018

For nearly twenty years, Ambridge Partners has pioneered the underwriting of representations and warranties (“R&W”) insurance¹ as a managing general agent for facilities of highly-rated insurers². The use of R&W insurance in M&A transactions has increased significantly during this time, with global policy placements rising from roughly 100 in 2011³ to more than 2,000 in 2017⁴. Many professionals now believe that R&W insurance is a necessary deal component, particularly in middle-market transactions, where the construct is routinely baked into auction drafts and utilized as a bid enhancement.

Despite steady annual growth in policy placement, R&W insurance is applied in less than 20% of domestic transactions overall (versus nearly 60% in the UK and more than 90% in Australia)⁴. The product has been particularly under-utilized in the healthcare space, where R&W insurers have been averse to the regulatory and billing risks commonly associated with the industry. Ambridge, however, has developed a team of legal, financial, and tax professionals dedicated to underwriting these specific risks. The Ambridge healthcare team, on behalf of its insurers, has deployed total limits of liability in excess of \$1 billion on healthcare R&W deals. For 2018, Ambridge continues to serve as the single largest source of R&W insurance capacity worldwide, capable of offering up to \$175 million in coverage limits per transaction through a consortium of markets with claims-handling authority delegated to one lead insurer.

It has been predicted that global healthcare M&A activity could rise to \$418 billion in 2018, up 50% from \$277 billion last year, with North America accounting for well over half of such transactions⁵. Given increasing demand for R&W policy placement and the current state of the healthcare M&A market, Ambridge continues to devote significant resources to underwriting R&W insurance for healthcare deals in 2018. The following practice points should help guide deal lawyers, insurance brokers, private equity sponsors, strategic buyers, and other parties who may be interested in procuring such coverage.

Scope of Diligence

During the underwriting process for healthcare deals and in general, Ambridge relies on the diligence conducted by the buyer and its advisors. Assuming this diligence is appropriate in scope relative to the target company operations and the breadth of representations in the transaction agreement, Ambridge will endeavor to underwrite coverage for virtually all regulatory and billing risks attendant to healthcare deals, except as noted below. It is therefore beneficial for a buyer interested in R&W insurance coverage to retain sophisticated third-party advisors and engage insurance brokers in early discussions regarding the adequacy and scope of diligence.

In the context of healthcare deals, a buyer interested in coverage for billing risks would be best served engaging outside professionals to perform a coding audit, and would benefit from a clean reimbursement history and centralized billing functions at the target company level. A favorable review by buyer’s counsel of the target company’s privacy and notification procedures, recent security risk assessments, and EHR practices would lend itself to potentially broader coverage for HIPAA/HITECH, while a thorough analysis of compensation arrangements, referral relationships, and sales and marketing practices would be critical to coverage for healthcare fraud, waste, and abuse matters.

Access to Documents

Ambridge understands the demanding and time-intensive nature of M&A and strives to complete its underwriting process within three to five business days of receiving access to the transaction data room, deal documents, and buyer’s diligence reports. However, underwriting may be delayed if Ambridge is not afforded full access to the data room (including clean team folders), the disclosure schedules are not developed, or the buyer’s diligence is not substantially complete. Budgeting these factors into one’s deal timeline will make for a smooth and more efficient underwriting process for all parties involved.

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Exclusions from Coverage

R&W insurance should not be viewed as a substitute for fulsome diligence. As referenced above, Ambridge may seek to exclude from coverage subject matters that have not been thoroughly vetted, but for which material exposure may exist. Deal parties interested in R&W insurance should also resist agreeing to overly buyer-favorable representations and warranties to speed negotiations, as R&W insurance presupposes a well-negotiated and balanced transaction agreement. Off-market representations, such as to collectability of accounts receivable or full disclosure in a private company deal, may be qualified or, as a last resort, excluded from coverage under R&W insurance policies.

Assuming the buyer has completed an appropriate diligence exercise, R&W insurance should cover unknown, undisclosed liabilities with few exceptions. Material identified issues such as “red flags” in diligence reports will be excluded from coverage. Other customary exclusions include forward-looking statements, benefit plan underfunding issues, matters accounted for in the purchase price adjustment, the availability of net operating losses, and, in the case of healthcare provider deals, medical malpractice.

Conclusion

Disagreements over the scope of representations and warranties made by one party to another, or the scope, duration, or amount of a party’s indemnification obligations with respect to losses incurred due to the inaccuracy or breach of those representations and warranties, can often lead to deal-breaking negotiating gaps. This is particularly true in healthcare deals. However, when utilized appropriately, R&W insurance can bridge these gaps by serving to insulate deal parties, differentiate bids, and facilitate closing a deal. Buyers and their advisors would be prudent to include R&W insurance in their M&A toolkit.

Should you have any questions or need further assistance, please do not hesitate to contact Senior Underwriting Counsel Philip Z. Glorieux⁶ or any member of the Ambridge team.

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- 1 R&W insurance provides coverage for losses incurred as a result of inaccuracy or breaches of the representations and warranties made in a wide variety of business agreements. Most commonly, the product is utilized by the buyer of a business to respond to losses it has incurred as a result of breaches of representations and warranties made by the seller in the transaction agreement.
 - 2 Each of the insurers for which Ambridge underwrites is rated “A” or better by both A.M. Best and S&P.
 - 3 Representations and Warranties Insurance. Whitepaper – July 2017. Arthur J. Gallagher & Co.
 - 4 Representations and Warranties Insurance. Market Conditions – January 2018. Arthur J. Gallagher & Co.
 - 5 Global Transactions Forecast. Healthcare – 2018. Baker McKenzie LLP.
 - 6 Phil Glorieux is US-trained lawyer who spent six years in private practice counseling university medical centers and private equity clients in healthcare regulatory, professional liability, and transactional matters prior to joining Ambridge in 2016. While this article is geared primarily towards North American markets, Ambridge does have the capacity and capability to underwrite warranty and indemnity (“W&I”) insurance for healthcare deals in the United Kingdom, the European Union, and beyond through our wholly-owned subsidiary, Ambridge Europe Limited, and many of the principles discussed herein would still apply.

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