ICEN Risk Special Situations

Case Studies

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Introduction

The ICEN Risk team has a track record of using its underwriting expertise to provide creative insurance solutions to unlock issues or add value in special or distressed situations.

This has allowed clients to:

- ✓ avoid insolvency proceedings and so remove the necessity for asset sales
- ✓ obtain contingent risk protections enabling transactions to proceed
- ✓ benefit from strong financial covenant of insurance solutions
- ✓ secure title protection around key areas such as IPR
- ✓ realise full market value for assets maximising proceeds to creditors
- ✓ avoid personal liabilities for directors, shareholders and insolvency practitioners
- ✓ replace escrow with insurance and release cash
- ✓ manage tax risks associated with debt buy in structures
- ✓ manage risks associated with management equity resets

Case Studies

How we can approach contingent liabilities

Issue:
Environmental liability preventing solvent liquidation

Background:
A UK-based investment fund holding UK retail properties wished to wind-up its operations and distribute proceeds to its investors.

Issue:
At the time of acquiring the property, the Jersey vehicle had given the sellers an unlimited indemnity in relation to future environmental liabilities. The seller was about to appoint a liquidator to collapse the structure post sale and sought protection in order to allow the liquidator to distribute the sale proceeds in full.

Solution:
An insurance policy was issued to the Jersey company, the individual directors, and the liquidator (together with, his heirs, estates and successors) that enabled the directors and the liquidator to proceed to wind up the structure and distribute the sales proceeds without deduction for the outstanding environmental indemnity. Our policy was for a period of 7 years and provided £1m of cover.

Issue:

Sale of Intellectual Property Assets by distressed seller

Background:
A financially distressed, European manufacturing business was selling its proprietary design software assets. The acquiring fund was not willing to proceed with the transaction without a number of assurances, including that the seller owned the software code and that it did not infringe third party intellectual property rights.

Issue:
The buyer asked us to provide it with an insurance solution to cover a full suite of intellectual property warranties and an associated indemnity in the asset purchase agreement. Due to time and budgetary restraints, neither party had commissioned independent expert intellectual property due diligence.

The buyer was particularly concerned with protecting itself against the risks arising out of using and integrating the software package with its systems, including: the risk of the software infringing third party intellectual property rights, including where open source code was used in noncompliance with license requirements; challenges to ownership of the code, for instance arising out of a failure to obtain express intellectual property assignment agreements from developers, and validity challenges to registered/granted intellectual property rights, including trade marks.Without the financial covenant of the insurance policy, the sale would not proceed.

Solution:
In the absence of either sell or buy side intellectual property due diligence, using our in-house intellectual property expertise and sophisticated data driven underwriting systems, we worked with the buyer to develop a deep understanding of the intellectual property risks associated with the assets and the additional information required from the seller in order to provide a fulsome risk transfer solution.

An insurance policy was issued to the acquiring company, covering the intellectual property indemnity given by the seller thereby giving the buyer the comfort it required to be able to use and integrate the software with its own solutions. In addition, the seller was able to cap its liability at €25,000 and use the sale proceeds to fund its core business. Our policy was for a period of 6 years and provided €3m of cover. Further, as we undertook the diligence in-house, and provided guidance to the buyer and seller as to what information to look for, we saved the parties valuable time and expense, enabling them to focus on closing the deal.

Applying W&I Insurance Issue:

Issue:
Liquidation sale at market value

Background:
A leveraged PE backed company had breached its banking covenants and its creditors appointed a liquidator to realise proceeds on their behalf. The business, a German industrial components manufacturer, was successful despite being leveraged. A Japanese corporate wished to acquire the target company but was concerned about potential liabilities and the lack of recourse available on a sale by a liquidator.

Issue:
Neither the PE shareholder nor the liquidator were prepared to provide the buyer with customary warranties, while management did not hold shares and were not incentivised to do so. Given the presence of only one buyer the requirements of the Japanese corporate were deal critical

Solution:
Following discussions a solution was proposed whereby the buyer would conduct a robust due diligence exercise and accept a balanced suite of warranties against which incumbent management would undertake a disclosure exercise. The buyer had the benefit of an insurance policy and the liquidator was able to realise a realistic market value for the business. Our policy was for a period of 7 years and provided €15m of cover.

Issue:
Sale of distressed investment by PE seller

Background:
A buyer was identified for a distressed PE-held company but the sale was hampered by the fact that the two executive directors had recently left the business and been replaced by temporary management who had been instructed to execute the transaction. The buyer was concerned about potential liabilities in the target business, the likely limited disclosure the management team could undertake and the limited covenant strength of management standing behind the warranties.

Issue:
The buyer required a limited set of warranties ranging from fundamental to tax warranties. Without such protection the sale would not proceed.

Solution:
We worked together with the lawyers, the PE client, the remaining non-executive director and financial controller (who had knowledge of the business) to agree a suitable set of warranties in the circumstances. An insurance policy was issued to the acquiring company providing the buyer with sufficient comfort and allowing the PE fund to cap its liability at £1 and distribute proceeds.

Issue:
Asset sale by liquidator: Synthetic cover

Background:
A liquidator was appointed following the collapse of a UK construction business which operated in the railway sector. A buyer was found for some of the rolling stock assets.

Issue:
The liquidator was only willing to sell the assets on the basis that title to those assets was limited to his knowledge, but would offer no guarantee to title. The buyer was not willing to spend £2m without being certain that title was passing unencumbered.

Solution:
An insurance policy was provided with a limit of £2m and for a period of 5 years. The policy created a synthetic covenant that protected the buyer against a challenge to its title to the assets, or a claim for any debts which may have been secured against those assets. The liquidator avoided personal liability whilst facilitating a sale to a buyer who gained comfort from the provided synthetic covenant.

Issue:
Distribution of funds by administrator

Background:
An administrator was appointed by the shareholder of a solvent group of UK industrial manufacturing companies. This group had been selling subsidiaries and assets for a number of years and was in the process of disposing of the remaining business.

Issue:
The group holding company was to be liquidated and contained a number of liabilities as a result of contractual obligations in the sale agreements effecting nine previous disposals over the preceding five year period.

There were two issues to address: (i) the administrator was not willing to make a full distribution whilst there were outstanding liabilities and (ii) the buyer was not willing to accept warranties and indemnity protection from the holding company because of the intended administration.

Solution:
The new share purchase agreement capped the holding company's liability in respect of the warranties at £1 and the buyer was insured up to £5m. The policy issued to the buyer afforded it the protection it required, whilst at the same time freeing up the sale proceeds and giving the administrators the requisite comfort to enable them to distribute these immediately.

A second policy, with a £10m limit, provided a 'wrapper' of protection covering all the historic warranties and indemnities, insuring the holding company as warrantor of the previous nine disposals. Additionally, cover was included for both the administrator and the holding company directors, to protect them in the event that they were named in any future warranty or indemnity claim (a precaution for when the holding company had been wound-up).

The administrator was able to make an earlier distribution than would not have been possible without insurance. At the same time the administrator avoided personal liability and the shareholders removed potential liabilities which could have reduced their return.

Issue:
‘Known’ fraud preventing a sale

Background:
A PE manager looking to close one of its funds was trying to sell a final portfolio company to an Irish company in the same sector. Prior to the sale, it had uncovered a fraud incident by the financial director of the company and, following an investigation, had terminated his employment (approximately six months before the sale process started). An interim financial director had been appointed.

Issue:
Whilst the detected fraud was less than £50,000 the buyer was worried about the risk of further, undiscovered dishonesty or wrongdoing by the dismissed financial director.

The buyer’s due diligence team conducted forensic due diligence around the former financial director’s activities, which they shared with us. The sale of the company stalled as the buyer would only proceed if they could insure the risk of further, undiscovered wrongdoing. The cover required by the buyer included fundamental warranties in case the financial director had encumbered the shares of the company. The selling institution could not provide the warranty and indemnity recourse that the buyer required.

Solution:
One insurance policy was provided: A buyer policy, with a £10m limit and providing a general level of recourse across the usual suite of warranties (including fundamental warranties) and tax indemnity. The risk of fraud by the seller and its management was not excluded by the policy.

In addition, we agreed to specific contingency cover around the potential for further undiscovered fraud by the former financial director, with a sub-limit of £2m within the W&I policy. This enhanced cover required a specific, aggregate excess of £250,000 and afforded the buyer with the protection it required, whilst at the same time enabling the transaction to proceed.
The PE investor was able to exit cleanly despite the issues it had previously discovered prior to the transaction.

Applying Tax Insurance

Issue:
Transactions in UK Land – collapse of structure

Background:
A Luxembourg-based private equity fund holding distressed UK industrial properties received an unsolicited offer to buy the shares in the property-holding companies.

Issue:
The seller's accountants raised the risk of the target potentially facing a liability to corporation tax under the Transactions in UK land rules as the properties were being sold within a five-year period. The amount of tax, if due, would be in excess of £30m. The seller was about to appoint a liquidator to collapse the structure post-sale and sought protection in order to allow the liquidator to feel free to distribute the sale proceeds in full.

Solution:
Two insurance policies were issued: one to the buyer to cover the Transactions in UK Land risk which was a risk the buyer was not prepared to take, particularly as it knew the seller was not creditworthy. The second policy was issued to the seller who would face primary liability to Transactions in UK Land risk. The sell-side policy also named the liquidator, his heirs, estates and successors and enabled the liquidator to proceed to wind up the structure and distribute the sales proceeds without deduction for the contingent tax.

Issue:
VAT – Transfer of a Going Concern (“TOGC”)

Background:
Two parties to a “fire sale” of a high-value real estate asset by insolvency practitioners considered that the transfer should be the transfer of a going concern. The buyer was not prepared to risk 20% of the sales proceeds being subject to VAT if HMRC queried the tax treatment in the future.

Issue:
Due to the rules on TOGCs and the lack of certainty provided by legal advice on the point, the buyer would not complete the transaction without escrow or insurance given the selling insolvency practitioner was not in a position to offer any form of indemnity on the point.

Solution:
An insurance policy was issued to the buyer as the seller was certain the sale was a TOGC and therefore did not wish to contemplate a lengthy escrow. The underwriting process was complete within 48 hours of being instructed.

Issue:
Option to Tax & Liquidator

Background:
A distressed real estate asset was being sold by a liquidator to a large corporate buyer. The diligence team could not trace an original option to tax for VAT purposes such that there was doubt as to whether or not the liquidator should charge VAT to the buyer.

Issue:
The liquidator and his advisors had written to HMRC to seek comfort that no option to tax existed. HMRC gave a response which gave some comfort but understandably was caveated. The liquidator was not prepared to give an indemnity to the buyer in the event an option to tax was discovered such that VAT was due under the sale agreement.

Solution:
We issued a policy to the buyer to cover the risk that an option to tax was discovered in the future with a policy limit of £20m. This became a significant issue on the deal with the liquidator potentially facing liability if an option was found and the buyer seeking comfort on the point with such a large amount at stake.

Issue:
Loan relationships on distressed sale

Background:
An operating business was being sold by a private equity fund to a US corporate buyer and the target business had breached banking covenants and was distressed.

The buyer wished to purchase a business with a repaired balance sheet and proposed a pre-sale restructuring, to separate the operating part of the business from the property-owning part. In formalising these proposals, the buyer identified a risk that there could be a charge to corporation tax in respect of the proposed pre-sale debt tidy up. The seller did not wish to give a long indemnity for the risk as it was about to appoint a liquidator to close down the structure.

Issue:
The risk of a corporation tax charge being triggered by a waiver of debt, to be given as part of the pre-sale debt tidy-up, was assessed as low, but the quantum of the potential charge (over £100m if the assessment proved incorrect) was severe that the buyer was unable to buy the assets without insurance for the risk.

Solution:
We worked collaboratively with both the buyer and the seller and their advisors to cover the risk and we led a tower of insurance. This issue became a deal-breaker but the insurance provided the solution on a challenging transaction where the business could have become insolvent if the sale did not go through.

Issue:
‘Known’ tax liability impacting a sale

Background:
A successful but leveraged food business breached its banking covenants. The bank supported the company but instigated a debt for equity swap as part of a restructure to trade forwards. Two years later, the shareholders wished to exit and a buyer was found. Our underwriters were already engaged on providing the buyer with a general W&I policy and the parties a proached us to see if we could provide a solution to the potential debt for equity swap tax risk.

Issue:
The buyer’s due diligence team discovered a defect in the way the historic debt for equity swap had been carried out. The sale of the company stalled as the buyer would only proceed on the basis that £2m was put in escrow for a period of six years. The selling institution was not prepared to leave £2m of a £19m sale tied up, preventing distribution.

Solution:
A bespoke policy was issued to the buyer, providing a general level of recourse across the usual suite of warranties and tax indemnity with built-in cover for the ‘known’ debt for equity tax risk. This policy afforded the buyer the protection it required, whilst at the same time freeing up £2m of cash which would otherwise have been trapped for six years. The buyer had said that it would reduce the purchase price by £2m if the escrow or insurance options were not available.

Issue:
Residence and liquidator action

Background:
A professional services firm had successfully brought liquidation proceedings in the English courts in their capacity as insolvency practitioners of an offshore business The company in liquidation received substantial damages as a consequence.

Issue:
Due to the litigation being brought in the English courts, with a UK tax-resident insolvency practitioner, the risk had been identified of the offshore company potentially having become UK tax-resident. The insolvency practitioners would face personal liability for such tax if they became due and the sums were significant.

Solution:
We issued a policy to each of the insolvency practitioners, having reviewed their actions and key decision-making over the preceding 5 years. The policy, which was for a 10-year term, also covered their heirs, successors and estates. The professional services firm had reviewed existing insurance and found it would not cover such a unique situation.

Experience. Expertise. Innovation. Creative Solutions.

How can we help you and enable a transaction which would otherwise not proceed?

Could we provide a unique solution which adds financial value to your transaction?

Hopefully the real examples above provide you with an insight to how our combined experience and expertise enable us to work creatively and find ways to help you with something similar or totally different.

Please contact us through your insurance broker and we can speak to you confidentially to see how we can help.

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