Litigation Mitigation... How Insurance Can Address Judgment Risk

Litigation can be costly, uncertain and time-consuming. Legal disputes not going the way one expected is a drain on a company's balance sheet, as well as a potential deal-blocker in M&A.

Whether it be any form of dispute resolution or arbitration, litigation is usually a complex and unpredictable process. This is even more so in cross-border transactions, which are ever-increasing in M&A today and amplifies the uncertainty for transaction parties and their advisors.

Litigation Risk Insurance can be an effective tool for these scenarios, and it covers a variety of exposures including potential or on-going litigation or arbitration, successful appeals by a counterparty, and other contractual disputes.

The most popular Litigation Risk Insurance solutions fall into the following two areas:

- **Adverse Judgment Insurance**

  Protects parties involved in ongoing litigation, or those that may be subject to future litigation, against the risk and financial liability of a potentially material adverse judgment.

- **Judgment Preservation Insurance**

  Covers any risk associated with a judgment being overturned or the awarded amount being decreased. It can be used to provide further certainty and potentially monetise the process and allocate capital elsewhere.

These solutions are tailored to each case and can be especially helpful in an M&A scenario, where a target entity is involved in a legal dispute. A Litigation Risk Insurance policy can give a buyer or investor the financial protection to proceed with a deal, even while the underlying litigation which the target entity is involved in remains pending. For sellers, it can also be an effective solution to substitute an indemnity under the transaction agreement for certain litigation risks identified during the due diligence process.

"Litigation Risk Insurance can be crucial in a transaction scenario where one of the parties is involved in material litigation proceedings, helping to eliminate the need for large escrows, and the resulting loss in liquidity, for lengthy periods of time. This type of insurance can remove potential deal-breakers, allowing a transaction to close that otherwise may have fallen over or been put on hold subject to the outcome of the litigation."

Camila de Carvalho, Associate Director, Transactional Risks, UIB

In addition to M&A, Litigation Risk Insurance can also help outside of a transaction scenario. It can benefit companies from an operational standpoint by enabling them to better manage potential liabilities from and provide certainty surrounding known litigation. This avoids the need to maintain material on-balance sheet provisions for any adverse outcomes and financial downside.

These insurances offer both financial and commercial stability, providing certainty on a balance sheet by turning a contingent liability into a quantifiable insurance cost, which can be a considerable advantage for companies.

"For a Litigation risk to be insurable, Underwriters like to see a legal opinion from a reputable law firm with relevant expertise, which sets out the factual background, analyses the applicable law/regulation, details the loss that may be suffered and reaches a clear and quantified conclusion as to the likelihood of the risk materialising. A risk is more likely to be insurable if the insured can demonstrate a clear commercial rationale for seeking to insure it."

Natasha Shoult, Senior Underwriter, Contingent Legal Risk Insurance, Liberty GTS

Litigation Risk Insurance – Key Points

- Coverage under litigation risk insurance is triggered following the outcome of the judgment or disposition of a litigation, at the point when no further appeals are allowable by either party.
- Due diligence and underwriting of these policies are fact-intensive and detailed.
- Premium rates: 3-15% of the Insured Limit.

Case Study

Liberty Global Transaction Solutions™

A company was awarded significant damages at arbitration following a dispute with its counterparty to a long-term commercial contract, which was found by the arbitral panel to have been wrongfully terminated by the counterparty. The counterparty lodged an appeal in the local court of first instance. Pursuant to a written decision, that court confirmed the arbitration award.

The counterparty then filed a further notice of appeal with the competent appellate court. The company, having received the damages from the original arbitral award, wished to find a means to allow it to deploy those funds for business purposes elsewhere in its group as the ultimate decision of the appellate court was likely to take years.

The solution to this problem was to purchase a Litigation Risk Insurance policy which covered the company against the risk of being required to repay the arbitral award by an adverse appellate court judgment. The policy gave the company the necessary protection to free up those funds for use in its business.

Whenever there is enough information for an Underwriter to review a Litigation Risk, we strongly recommend the parties involved in such litigation process to consider the benefits of a stronger negotiating position and the peace of mind that Litigation Risk Insurance can provide.

Although Litigation Risk Insurance is not a solution for any and all litigation risk, it can be a key solution for a party with a defensible position to protect against the unforeseeable outcome of a legal dispute.

If you would like to discuss any of the points mentioned in this article or any other matters related to Transactional Risks, do not hesitate to contact one of our specialists at UIB.

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