

# NY Merger Ruling Offers Costly Lesson On Vague R&W Terms

By **Jason Dubner and Mark Schwartz** (February 1, 2021)

Subject to their particular terms and conditions, representations and warranties insurance, or RWI, policies provide indemnification in the mergers and acquisitions context for covered losses arising out of sellers' unknown breaches of representations and warranties.

Because most RWI policies contain mandatory arbitration provisions, public decisions resolving disputed RWI claims remain scarce. Particularly as the M&A/transactional risk industry reports a rising incidence of high-dollar claims, WPP Group USA Inc. v. RB/TDM Investors LLC,[1] in the New York Supreme Court, promises rare guidance regarding how such claims may be resolved.

WPP involves a dispute over an alleged breach of a representation regarding the sellers' revenue projections reflected on certain schedules attached to the purchase agreement, which the buyer contends were made "as of the date of this Agreement and as of the Closing."

The case also examines the scope of interim breach and covenant breach exclusions in an RWI policy issued as part of the transaction. On Jan. 15, the WPP court denied motions to dismiss brought by the RWI carrier and the sellers, finding that ambiguities in the purchase agreement and disputed fact issues precluded dismissal at the pleading stage.

While deferring an ultimate ruling as the parties continue to litigate, the WPP court's opinion illustrates the potential for costly coverage disputes — and potentially, even more costly exposure — arising out of contract terms that the court found ambiguous.

## Factual Background Leading to WPP's Complaint

In the fall of 2016, WPP Group USA Inc. agreed to purchase Triad Retail Media — a digital retail media company — for \$300 million. As part of the transaction, WPP obtained a buyer-side RWI policy from PartnerRe Ltd. with a limit of \$40 million above an initial \$3 million retention.

Subject to the RWI policy's terms, conditions and exclusions, PartnerRe agreed to insure WPP against losses it suffered as a result of breaches of representations and warranties made by the sellers in the purchase agreement executed on Oct. 12, 2016.

The purchase agreement included disclosure schedules containing Triad financial data as of August 2016 and good faith projections as of the Oct. 12. effective date for the remainder of the 2016 calendar year. The parties dispute whether the sellers also represented that those projections were a good faith projection as of the closing five weeks later.

The purchase agreement required the sellers to disclose material variances from the representations and warranties made in the contract, and required the sellers to certify at closing that they had complied with various covenants, including a covenant to update the good faith financial projections.



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On Oct. 26, during the period between signing and closing, the sellers provided WPP with an updated forecast that reflected diminished financial projections. According to WPP's complaint, however, the sellers failed to disclose that their projections — both as stated in the purchase agreement and as updated on Oct. 26 — were substantially overstated.

In fact, shortly after closing, WPP learned that Triad's 2016 calendar year earnings before interest, taxes, depreciation and amortization and revenue projections were millions of dollars less than what the sellers had stated in both of their preclosing disclosures.

On Nov. 16, 2017, WPP notified PartnerRe of a claim under the RWI policy based upon the sellers' alleged breaches. PartnerRe denied WPP's claim, prompting WPP to sue PartnerRe, along with a group of individual investors/sellers, to recover more than \$40 million in damages arising out of the sellers' alleged breaches of representations, warranties and covenants made with regard to Triad's financial condition.

### **PartnerRe's Motion to Dismiss**

On Jan. 16, 2020, PartnerRe moved to dismiss WPP's complaint on several bases. As an initial matter, the insurer joined the sellers, who argued that the purchase agreement did not require any update to the schedules containing Triad's revenue projections, which they claimed had been made in good faith only as of the date they were disclosed on Oct. 12, 2016.

In the alternative, PartnerRe maintained that either of two RWI policy exclusions provided a basis for the court to grant its motion to bar coverage.

First, PartnerRe invoked a provision that excludes any portion of loss "arising out of any ... Interim Breach," a term defined as any breach with respect to which "(i) the facts, events or conditions that caused such Breach to exist first occurred during the Interim Period ... and (ii) any of the [WPP] Deal Team Members first obtained Actual Knowledge thereof during the Interim Period."

Second, WPP asserted an exclusion that bars coverage for any portion of loss "arising out of the specific indemnities set forth in Sections 11.2(A)(2) and (3) of the Purchase Agreement," including breaches by members of the company for a failure to comply with or perform a covenant or obligation set forth in the purchase agreement on or before closing.

WPP responded by emphasizing language in the purchase agreement that required good faith revenue projections "as of the date of this Agreement and as of the Closing." WPP maintained that it had not pled any actual knowledge of the breach until after Triad's financial condition was disclosed post-closing, and, as such, the interim breach exclusion could not apply.

WPP also argued that, notwithstanding what PartnerRe referred to as the covenant breach exclusion, PartnerRe had separately agreed to insure the sellers' certificate representations, which included representations that the company and sellers had complied with all covenants as of the closing.

In reply, PartnerRe argued that WPP's complaint included factual allegations showing that WPP did have actual knowledge of alleged preclosing breaches by virtue of the buyer having received the Oct. 26 financial projections. PartnerRe also argued that WPP's interpretation of the covenant breach exclusion would render the provision meaningless.

## **The Court's Ruling**

On Jan. 15, 2021, the New York Supreme Court issued an opinion denying the defendants' motions, holding that fact issues precluded dismissal. With respect to the defendants' argument that the sellers were not required to provide updated financial projections, the court concluded that the financial schedules in the purchase agreement were ambiguous.

Specifically, the court held that one could reasonably interpret the disclosures in the purchase agreement to include the sellers' good faith financial projections as of the date of execution and as of the date of closing. As the court explained, "it is reasonable per the preamble to Section 5, that if unchanged, the Seller Defendants warranted the continued good faith of the 2016 annual projections in section 5.5(C) as of the November 17, 2016 Closing."

Because the schedules were ambiguous, the court found that dismissal was not warranted at the pleading stage. The court further held that the impact of the sellers' disclosure of updated forecasts during the interim period created a question of fact that could not be resolved without discovery.

Turning to PartnerRe's invocation of policy exclusions, the court again held that discovery is warranted. With respect to the interim breach exclusion, the court noted that the exclusion applies only to the extent that a breach first occurred during the interim period and only if WPP first obtained actual knowledge during the interim period.

The court concluded that it could not infer such actual knowledge on PartnerRe's motion to dismiss, and instead held that discovery is required to determine whether and, if so, when, WPP had the requisite knowledge for the exclusion to apply. The court also found that the exclusion precludes recovery only for the portion of any loss within its ambit and that discovery is needed to determine the portion of any such excluded loss.

As for the covenant breach exclusion, the court concluded summarily that "coverage might not be precluded" if it determines that the exclusion renders coverage under the RWI policy illusory. Because the court found ambiguity in this interpretation of the RWI policy's exclusions, it denied PartnerRe's motion to dismiss on that basis as well.

## **Implications for Practitioners**

Despite its brevity and limited analysis, the WPP court's Jan. 15, 2021, opinion provides some meaningful guidance for practitioners hoping to avoid post-closing disputes and unanticipated RWI claims. In general, WPP illustrates the potential for protracted litigation and the prospect of significant liability for sellers and RWI carriers alike if a court finds that contract language is unclear.

For example, RWI underwriters typically seek to avoid coverage for interim breaches, and PartnerRe certainly intended as much in the RWI policy it issued to cover the Triad transaction. As a result of language that the court found ambiguous, however, PartnerRe might ultimately end up liable for covered losses arising out of the sellers' failure to provide accurate projections during the interim period.

Had the parties more clearly articulated the scope and timing of the sellers' representations regarding the good faith accuracy of Triad's financial projections, PartnerRe's interim breach exclusion would more likely have negated the claim.

Likewise, carriers routinely exclude RWI coverage for covenants. In WPP, however, purportedly ambiguous language opened the door for possible insurance coverage for covenants masquerading as representations as to the accuracy of certificates of compliance.

Practitioners are likely to gain additional insights as the WPP litigation proceeds. But for now, the case stands as a cautionary tale that illustrates the time, expense and potential liability stemming from contractual provisions that a court might find unclear.

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[1] WPP Group USA Inc. v. RB/TDM Investors, LLC, Index No. 656825/2019 (N.Y. Sup. Ct.).