



DON'T CASH THAT CHECK

Maximizing the Value of Representation and Warranty Claims

ASSESSING THE POTENTIAL FOR A CLAIM

Do you have an economic breach?

Economic breaches are commonly related to financial statements. However, other economic terms such as material customers, contracts, suppliers, and undisclosed liabilities can also cause a breach. One study reported that 51% of claims made and 57% of claims paid are based on economic breaches¹; another reported that 65.7% of claims paid were based on economic breaches.²

Examples of breaches that have resulted in claims paid include:

Revenue recognition:

- percentage complete accounting
- estimates for discounts and allowances
- rebates and returns
- timing and cutoff issues

Recognition and classification of expenses:

- bad debt
- warranty
- contingent liabilities



HOW MUCH MONEY DID YOU LOSE AS A RESULT OF THE ECONOMIC BREACH?

Losses can appear in the form of purchase price adjustments, out-of-pocket costs, and lost profits depending on the nature, timing, and extent of the breach.

Purchase price adjustments can be a one-time, dollar-for-dollar adjustment or have a durationally significant impact lasting years after the transaction. The

calculation considers purchase price that would have been paid "but-for" the economic breaches (i.e., if the buyer had knowledge of the information; e.g., financial statements that accurately reflect the financial condition of the company).

Using actual post-closing knowledge, lost profits and out-of-pocket costs can be calculated for the past and estimated for the future. Lost profits are measured by calculating the difference between the profits that were expected to be earned but for the misrepresentations and the actual profits earned over a loss period, which generally ends when the business returns to the expected level of profits.

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INTELLIGENCE THAT WORKS

¹ Lockton Companies, "The Americas," Lockton Transaction Liability Insurance: Market Update (2023), pp. 10–11.

² Euclid Transactional, Euclid Transactional Global Representations & Warranties Insurance Claims Study (2023), pg.8.