Preserving Insurance Coverage in Acquisition Transactions

By B. Scott Burton

As the economy is experiencing an uptick in merger and acquisition activity once again, the speed that parties demand to come to terms and close transactions also is accelerating. Aggressive timelines and competition among potential bidders can lead to abbreviated diligence of a target. Compressed diligence processes risk missing or underestimating potential exposures of the target. An often overlooked tool that can serve as transaction protection is commercial property and liability insurance coverage that may be available to the target. While today’s insurance market has a number of products tailored to the M&A market (e.g., representation and warranty insurance—a topic to be addressed in a future paper), an appropriate assessment of what casualty and liability insurance coverage already exists at the target and a plan to continue that coverage in the post-closing environment can help in addressing any future surprises.

What Risks Should the Buyer Evaluate?

In a merger or stock acquisition of a company, the buyer typically succeeds to the liabilities of the acquired entity. If the target has been in business for a long period of time, has itself been very acquisitive, and/or is a very complex organization, confidentially identifying all of the potential sources of liability can be a daunting task—particularly if the transaction is proceeding on an accelerated time frame. Prior activities, seemingly “stale” claims or environmental claims are all potential future exposures.

Even under asset acquisitions or other types of “business acquisitions” (i.e., situations in which the buyer purchases a part of or a “select business” of a bigger enterprise, which may be combined with other entities, assets or rights), the buyer may be subject to possible liability related to the assets, or the existing insurance coverage itself may be an asset the buyer acquires.

Performing Due Diligence on Insurance Coverage

As in virtually every transaction, the buyer’s best protection is thorough diligence of not only potential exposures but also the insurance coverage that the target utilizes to manage those exposures. To that end, the buyer might consider undertaking the following:
- Evaluate the target’s risk management and insurance coverage infrastructure (e.g., how is the target’s insurance coverage procured, how are claims managed, etc.);
- Request copies of the target’s current and historic insurance policies (including any parent or affiliate coverage that may be applicable to the target);
- Request claim history for the past five to seven years of the target (including any predecessor entities) and its assets;
- Request conversations with the target’s risk managers and, if possible, its insurance brokers (the latter request would typically be granted after the buyer is deep in the process with the seller/target); and
- Importantly, utilize insurance experts and brokers to try to anticipate what coverage will be necessary and available after closing.

Once much of the requested information is gathered, the buyer should undertake a careful and comprehensive review of the target’s insurance landscape. The buyer’s primary focus may encompass the following:

- What insurance coverage is available/applicable to the target and its assets (including in-force policies plus any legacy policies under which claims may be made)?
- What is the quality of the issuing insurance companies?
- Are the policies “claims-made” or “occurrence-based” policies?
- If the policies are “claims-made,” confirm that any required notices have been appropriately delivered pursuant to the policy terms.
- Also, determine if “tail coverage” is available under any “claims-made” policies.
Do the policies contain high deductibles or retrospective premiums?

Does the target utilize an insurance captive or fronted policies?

What are the policy limits and how much, if any, has already been utilized? Likewise, how much of the deductibles have been utilized?

Are there any unusual exclusions under the terms of the policies?

Can the policies be transferred to the buyer in connection with the acquisition of the target (more about this topic below)?

Assessing the Risk

Important pieces of information that will benefit the buyer include an assessment of the risks and exposures of the target and an understanding of the potential for insurance recovery. This information is necessary to intelligently determine the price for the target as well as to determine what risks or liabilities to accept or allocate to the seller. Likewise, it is probably useful to consider how the target’s risks could be managed by the buyer in the post-closing environment, particularly as they pertain to the need for other coverage (including “tail coverage”) or greater insurance coverage and access to and preservation of the target’s books and records.

“… the buyer’s best protection is thorough diligence of not only potential exposures but also the insurance coverage that the target utilizes to manage those exposures.”

The Purchase Agreement: Useful Provisions

The representations and warranties, along with the covenants contained in a negotiated purchase agreement, should be used to confirm insurance diligence efforts and to ensure that the anticipated insurance coverage will be available until and after the closing.

With respect to representations and warranties, the buyer might consider requiring assurance that:

- The seller has provided copies of all relevant insurance policies and current pending insurance applications;
- The seller has provided accurate descriptions of any self-insurance, retention arrangements or captive insurer facilities used to manage liabilities;
- The seller has provided accurate information regarding claim history and experience under its insurance policies;
- All insurance policies are valid and enforceable against the insurer;
- The insurance policies were issued by financial sound insurers;
- The insurance company is adequate (perhaps by comparison with companies in the same business as the target);
- The insurance policies will continue in full force and effect following the closing (and listing any consents or notices that may be needed to assure such continuation);
- All required premiums to be paid with respect to such insurance have been paid, and other obligations by the insured have been performed;
- The target/seller has given proper notice to the insurer of all insured claims;
- The target/seller has not been notified of any cancellation of coverage, of any material change in coverage or policy terms, or of a material increase in future premiums; and
- All information provided to any insurer in connection with coverage, including the application for insurance, was accurate and that the target/seller has not provided any other information to any insurance company that could likely result in the cancellation of an insurance policy or the denial of coverage for a specific risk/claim.
Likewise, the buyer can request a number of covenants from the seller/target. For example, the buyer should consider requiring that:

- The seller manages its insurance program through the closing in a manner consistent with past practices;
- The seller continues to pay all required premiums and otherwise continues to maintain its insurance coverage;
- The seller continues to timely file all relevant claims that arise prior to the closing;
- The seller cooperates with the buyer to transfer all insurance coverage to the buyer following closing;
- The seller cooperates with the buyer in the event that the buyer wishes to procure “tail coverage” or other coverage on the target post-closing; and
- The seller provides the buyer with the historical records (or access thereto) so that potential future claims can be adequately managed.

The buyer can expect the seller to object to and negotiate these provisions as would be the case with any other purchase agreement provision. The buyer’s success in getting its needed protection will be enhanced by quality diligence and understanding post-closing insurance options.

“The representations and warranties, along with the covenants contained in a negotiated purchase agreement, should be used to confirm insurance diligence efforts and to ensure that the anticipated insurance coverage will be available until and after the closing.”

**The Perils of Assignment and Change of Ownership**

Insurance policies are contracts between the insured and the insurance company. Like other contracts, the form of acquisition (e.g., stock purchase, merger, asset purchase) may influence whether and how insurance policies remain with the target following the acquisition. Often such contracts may not be transferred without the consent of the insurance company. Likewise, a “change in control” of an insured may trigger consent to future coverage or, in some cases, a “run-off” provision, allowing coverage to continue but only for events taking place prior to the change. The various requirements should be recorded as part of the diligence process. In addition, the buyer would be well advised to check applicable law on the form of the acquisition and the resulting requirements under the policies in question.

Finally, often where assets, divisions or subsidiaries of the seller are acquired, the parent company will be the named insured and thus transferring or otherwise assigning the insurance policies may be, at best, impractical. In these cases, the buyer and seller may be able to negotiate with the insurance company to bifurcate coverage or otherwise provide coverage on the target. This endeavor can be quite complex and time consuming but is a scenario in which the buyer’s insurance broker may be of the most help.

Participating in acquisitive transactions in today’s environment requires experts, efficiencies and good planning. There are a host of potential complexities in evaluating a target’s risks. Understanding and preserving insurance coverage is certainly one of the more daunting yet critical tasks. Nevertheless, a good team with a good plan can preserve coverage and plan for surprises—two key ingredients for a successful deal.

---

About the Author: **B. Scott Burton** leads Sutherland’s Insurance Finance team, guiding both buyers and sellers through the acquisition and/or disposition of private or publicly held insurance entities. He can be reached at: scott.burton@sutherland.com.