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Insurance Issues In Mergers And Acquisitions: Key Tips For Transactional Lawyers

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2018 was one of the busiest years on record for merger and acquisition activity. Many analysts attributed the surge to the ambitions of Silicon Valley heavyweights. As technology companies made inroads in the media, entertainment and healthcare sectors, more established players turned to strategic transactions to win back market share and upgrade their business models.

But all M&A transactions are not made equal; more than one company has been weighed down by acquired liabilities. This post highlights important insurance-related issues that a company would be well-advised to consider before pulling the trigger on a strategic transaction in 2019.

Identify Uncovered Liabilities

If your company is looking to acquire or merge out another company, a best practice is to review the target company's insurance policies (and any other contracts that might grant it indemnification) as part of the due diligence. This is because the true value (or cost) of the transaction may turn on whether the target company's known and anticipated liabilities are covered by insurance.

If uninsured liabilities are discovered, the purchase price can be adjusted or the seller can agree to indemnify the buyer as appropriate. To identify uninsured liabilities, best practices for buyers include:

- Analyze the seller's most substantial liability exposures and determine whether they are covered, in whole or in part, by the relevant insurance policies

- Scrutinize the seller's claims history to determine whether settled liabilities are likely to reoccur and, if they do, whether they might be covered under the seller's existing insurance programs

- Chart the seller's current and historic insurance policies to more easily examine whether the limits of those policies are adequate and available. For instance, the policies could have been exhausted by claims or commuted by the target company.

- Research whether the insurance companies underwriting each policy are solvent and/or have strong long-term financial viability. Insurance companies in liquidation, run-off or under receivership may not be able to pay covered claims at 100 cents on the dollar.

- Analyze the company's contracts with suppliers, customers or corporate affiliates to identify any indemnification provisions or additional insured requirements.

- Review the seller's past acquisition, merger or divestment agreements to determine how insurance assets were treated.

- Identify any anti-assignment clauses that – depending on the transaction type and applicable law – might be cited by insurance companies in efforts to eliminate coverage if the insurance policies are transferred from seller to buyer

Run-Off Coverage

After identifying any uninsured liabilities, a follow-up best practice is to determine whether the buyer's or seller's existing insurance policies should be modified, or new coverages should be purchased, to address seller liabilities that are new or different from those faced by the buyer.

For example, directors and officers (D&O) insurance policies are written on a "claims made" or "claim made and reported" basis. In either case, these types of policies typically cover claims (such as lawsuits or investigations) brought against the insured during the effective dates of the policy. If a claim is made against the seller's directors and officers after the D&O policy expires, there may be no coverage for the claim.

To address this coverage gap, buyers and sellers can purchase "run-off" (aka "tail" coverage) for the target, which would extend the D&O coverage for a specific number of years to allow the policy to respond to post-acquisition claims arising from the pre-acquisition conduct.

Both buyers and sellers have an interest in considering this type of coverage because, on the one hand, it creates coverage dedicated to the seller's directors and officers while, on other hand, protecting the limits of the new subsidiary's (or parent's) D&O program from being eroded by pre-acquisition conduct.

There are a whole host of insurance-related issues that a buyer should be mindful of when considering a strategic transaction, which is why it is important to put together a strong due diligence team capable of evaluating risk and preserving insurance assets before pursuing these transactions.