The Metropolitan
Corporate Counsel®

National Edition www.metrocorpcounsel.com

Volume 22, No. 12 December 2014

Mergers and Acquisitions: Identify, Analyze and Value Insurance Assets When Making Deals

Mark Garbowski

ANDERSON KILL

While international "tax inversion" deals found controversy and dominated the political headlines among merger and acquisition news stories this year, practicing attorneys are still focused on the nuts and bolts of making deals happen and protecting the interests of their clients on deals of all kinds.

Insurance policies represent a significant asset class that is often overlooked by the people putting together such deals. Deal makers often spend a great deal of time negotiating the transfer of historic liabilities but little or no time on the insurance policies that will cover any pre-closing liabilities assumed. Whether the acquired company or division has liabilities resulting from securities transactions, financial activities, environmental damage, toxic torts, or professional activities, such as design work or healthcare, its insurance policies represent an important source of potential recovery for those losses.

If you are advising a team that is acquiring another company and its liabilities, it will be vital to also acquire and properly value the insurance assets that might cover those liabilities. Conversely, if you are part of an organization that is selling or shedding all or part of a business and its associated liabilities, you can help your negotiating team get a better price if you can properly identify which insurance policies can and should be transferred as part of the deal, and cogently explain the value of those assets to the negotiators on the other side. On either side, this is an endeavor in which attorneys, risk managers, and finance professionals will need to cooperate to provide maximum value to their company or clients.

Mark Garbowski

Mark Garbowski is a Senior Shareholder in the New York office of Anderson Kill, a national law firm. Mr. Garbowski is a member of the firm's insurance recovery group, with particular experience in professional liability insurance, directors' and officers' insurance, fidelity and crime-loss policies, and Internet and high-tech liability insurance issues. He is also a regular contributor to the firm's Financial Insurance Law blog available at http://www.financialinsurancelaw.com.

Insurance: A Matter of Due Diligence

When acquiring or merging with another company, your first task relative to insurance will be to ask your negotiating partners for insurance policies and loss history data, and possibly to have that same information organized and available on your side. Be aware that a company that is or was a subsidiary might be entitled to coverage under multiple insurance programs: its own program, its parent's program, and possibly that of additional companies that were previously part of its corporate history.

Other research tools available to you are the legal research databases (Lexis and Westlaw) and Mealey's Insurance Reports. Use these information resources to see whether the company you are purchasing, or any of its affiliates, has ever sued or been sued by its insurance companies.

The second step for your due diligence team is to analyze the policies and information you find. The most important areas of inquiry are:

- Are the policies claims-made or occurrence based?
- How much of the coverage is real? Check for high deductibles, front policies, captives, or retrospective premium programs.
- What is the current status of exhaustion of the policy limits? This is necessary to put a realistic value on the policies.
- Similarly, has there been any progress to reaching maximums on retrospective premiums or deductibles? Have any retrospective premium programs been closed? Just as with the exhaustion of limits, this information is vital to valuing insurance assets.
- Are there any unusual exclusions in the policies? These are often added by insurance companies in response to an extreme or unusual loss experience. If so, they might alert you to undisclosed or unnoticed liabilities.
- If the insurance program is claims-made, what claims have been made? In addition, were any integrated notices, notices of circumstances, or notice of potential claims given under those policies?
- Also for claims-made policies, determine how much of an extended reporting period is included with the policy, and consider whether it might be worthwhile to purchase an additional extended reporting period, an extended discovery period, or even a special policy – sometimes called a "tail policy" or "sunrise policy," designed to cover new claims that arise for historical pre-merger activities.
- Has any coverage been settled or commuted, so that it is no longer available?
- How much of the coverage is with insolvent insurance companies or companies whose long-term financial viability is in doubt?

The third step is to bring the conclusions resulting from the insurance due diligence to the deal makers and to work with them to facilitate the deal. This is a

Please email the author at mgarbowski@andersonkill.com with questions about this article.

dollars-and-cents analysis and should be separated for each area of liability that the buyer and seller are negotiating. The team should predict the insurance recovery for each category of claims by creating one or two model claims for each category and evaluating which policies would cover the liability and how much will be uninsured (or “a gap”). With respect to potential future claims, to be of greatest use, the team should make these predictions using three scenarios: (1) nuisance claims, lots of defense costs and no indemnity; (2) moderate liability; and (3) catastrophic or “bet the company” size liability. The highest liability and greatest gap frequently is used to assess the transaction conservatively. The other due diligence teams may have made predictions about future liabilities, which should be considered as well.

Using this information, your negotiators can make a far more intelligent decision about which liabilities to accept and to what extent. For instance, if the seller claims that his company’s liabilities will never reach catastrophic levels, then you might ask for an indemnity for any liabilities above a set level for which your company cannot recover from insurance. Moreover, where the seller has been able to produce only a small fraction of the insurance that it could have and should have had, you might ask that company to retain a portion of the potential liability, reflecting the number of uninsured years. Where feasible, the team might suggest that those obligations be secured with a new insurance policy, perhaps a finite risk policy with a risk transfer component, or one written out of a captive. Which party pays the premium, or whether it is shared among parties, can be negotiated.

In addition to these areas for creative input, the team also can give important nuts and bolts advice on a number of other insurance-related issues:

- Ensure access to the seller’s insurance program for the recent years. This is a particularly thorny issue where part of the program is a captive.
- Are there any premium refunds due to the company you are purchasing? Again, in captive and finite risk programs, the subsidiary that you are acquiring might have made substantial investments. Your team may recommend leaving the funds with the selling parent in return for future access or recapturing the funds and placing them in your own insurance vehicle.
- If your company ever makes claims under the selling parent’s policies, who pays the resulting deductibles, retrospective or reinstatement premiums? While it may be relatively easy to agree to pay retrospective premiums, much care should be taken before agreeing to pay any reinstatement or renewal premiums. As a stranger to the selling parent’s insurance program, you never will know with certainty whether the allocation is fair or not.
- If the insurance program was claims-made, should your company give notice of any claims before the end of the current policy period? Should you buy an extended reporting period or separate tail policy? Who should pay for it?
- How best to affect the assignment of the policies? An express transfer spelled out in the agreement is best. There is a common rule that insurance policies travel with the liability, but its application is less certain than an express provision in the papers. In addition, many policies will have a “no assignment” clause. While these are usually not enforced for existing liabilities, check the law in all potentially relevant states and consider seeking approval in advance.

Cleaning up After the Fact

If you are faced with learning of the acquisition after the deal is done, steps can be taken immediately to protect your company in the future. The first thing to do is to find any long-time employees of the company you acquired who may have been involved in or knowledgeable about any relevant insurance programs. Do this quickly, before engaging in any related downsizing. When you find such persons, debrief them on where any old policies, claims files or the like might be found. Do the same with the brokers. The results of these interviews and any documentation found should be put in safekeeping, with all of your company’s other insurance policies.

If your company is sued for alleged pre-acquisition liabilities of the company it acquired, you must send notice to all of that company’s historic insurance companies that you have found. You should also send a letter to any prior owner of the company you acquired – not just the company that sold it to you – and demand that they put all of their relevant insurance companies on notice of these claims immediately. This might put your company in competition with the prior owners of the acquired company for insurance assets. Where two companies are claiming under the same policies, there may be no problem if the policies do not have aggregate limits applicable to the claims. However, where there are applicable aggregate limits, the rule generally is, first come, first served.

In sum, don’t forget your insurance assets, and use a knowledgeable team to “perfect” your interest in those assets.

• • •

Anderson Kill practices law in the areas of Insurance Recovery, Commercial Litigation, Environmental Law, Estate, Trusts and Tax Services, Corporate and Securities, Antitrust, Banking and Lending, Bankruptcy and Restructuring, Real Estate and Construction, Foreign Investment Recovery, Public Law, Government Affairs, Employment and Labor Law, Captive Insurance, Intellectual Property, Corporate Tax, Hospitality and Health Reform. Recognized nationwide by Chambers USA for Client Service and Commercial Awareness, and best-known for its work in insurance recovery, the firm represents policyholders only in insurance coverage disputes - with no ties to insurance companies and has no conflicts of interest. Clients include Fortune 1000 companies, small and medium-sized businesses, governmental entities, and non-profits as well as personal estates. Based in New York City, the firm also has offices in Ventura, CA, Philadelphia, PA, Stamford, CT, Washington, DC, Newark, NJ and Dallas, TX. For more information, please visit www.andersonkill.com and connect with Anderson Kill on Twitter @AndersonKillLaw.