# Buying a Company? Take a Look at its Insurance Portfolio

by Robert M. Horkovich and Mark Garbowski

Negotiators of a merger or acquisition may knock themselves out over reps and warranties, yet neglect to scrutinize the opposite party's insurance protection. Yet more than one company has been weighed down or in some cases buried by the liabilities it acquired with a new subsidiary or merger partner. Analysis of a potential acquisition or merger partner's historic insurance portfolio is an essential, if too often overlooked, aspect of M&A due diligence.

When acquiring or merging with another company, your first task will be to ask your negotiating partners for insurance policies and loss history data. Keep in mind that a company that is or was a subsidiary might be entitled to coverage not only under its own insurance programs but also under its parent's program, and possibly those of additional companies that were previously part of its corporate history. Make full use of legal research databases to determine whether the target company has ever sued or been sued by its insurance companies.

Once that information is gathered, consider:

- Are the policies claims-made or occurrence based?
- Are there high deductibles, fronting policies, captives or retrospective premium programs?
- What is the status of exhaustion of limits?
- Similarly, has there been any progress toward reaching maximums on retrospective premiums or deductibles?
- Are there any unusual exclusions? These often are added by insurance companies in response to an extreme or unusual loss experience, and might alert you to undisclosed liabilities.
- If the insurance program is claims-made, have any integrated notices, notices of circumstances, or notice of potential claims been 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, 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?

Next, conduct a separate analysis for each area of liability that the buyer and seller are negotiating. Scope out the potential 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 may be uninsured. With respect to potential future claims, it is ideal to analyze three scenarios: 1) nuisance claims, with lots of defense costs and no indemnity; 2) moderate liability; and 3) catastrophic or "bet the company" size liability.

Armed with this information, your negotiators can make an informed decision about which liabilities to accept. For instance, if the seller claims that his company's liabilities never will 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. 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. The allocation of premium cost can be negotiated. If the seller will not provide information and insurance cannot be purchased, the buyer must assume the liability will be passed on and must evaluate the deal in that context.

Your team can also give important advice on a number of other insurance-related issues:

- Ensure access to the seller's insurance program for 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?
- How best to effect 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. Notice should be given of the assignment.

A company's historic insurance assets can prove as essential to its value as its products and revenues. When considering a deal, do not leave insurance out of the equation. Use a knowledgeable team to "perfect" your interest in these vital assets. ■

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