Avoiding M&A Insurance Problems

by Joshua Gold

Regardless of the economic cycle, corporate transactions are always taking place, whether through mergers, acquisitions, going private, or, in a recent trend, marriages between financial institutions arranged by the Treasury and the Federal Reserve. These transactions often have at least one common complication: insurance.

For a long time, scant attention was paid to insurance assets in even some of the larger M&A deals. Over the past decade or so that has changed with insurance taking up a more prominent piece of the due diligence checklist. The insurance review, however, usually does little more than scratch the surface. There are a number of reasons for this, including the fact that insurance is typically not a major driving force to consummating a deal and often the attorneys and investment bankers spearheading the deal have little real-world appreciation for the nuances and land mines that inhabit the insurance claims world. Given that, there are some important steps to take to help avoid insurance problems in the M&A process.

1. Determine ownership of insurance. One of the most important starting points is to arrive at an express written agreement as to what insurance policies will be part of the acquisition (i.e., who will own the insurance policies?). Creating an inventory of policies starting with the present and going back as far as possible is a good way to determine what insurance assets will be transferred. It is not unheard of for one or more former corporate subsidiaries sold to different buyers to later stake competing claims on insurance that may have protected them originally on a consolidated basis. Even the former parent may lay claim.

2. Account for insurance in the purchase price. Although there are numerous variations on how parties to a merger or acquisition may handle insurance, on occasion policyholders who are selling off a division, subsidiary or operating unit may opt to keep the insurance rights to a pending insurance claim even though they are selling off the business unit that was implicated in generating that claim. A few issues arise with such a scenario. First, the fact that the insurance coverage right is being retained and not transferred should be set forth in the operative deal documents. Second, it would follow that the purchaser of the business unit would adjust the acquisition price to reflect the asset being acquired minus the insurance recovery. Third, some agreement should be made over future cooperative efforts to recover on the insurance policy should the insurance company seek further claim information or contest coverage.

3. Avoid surprises. During the M&A due diligence phase, great care is given to assessing liabilities of the target and getting a comprehensive list of pending litigation. With each listed liability, it is important to match that suit to an insurance policy and determine its status. Is the purchaser buying not only a pending litigation but an insurance coverage dispute as well? Have all notices, proofs of loss and other forms of information been provided to the appropriate insurance company to avoid arguments over time-sensitive clauses in the insurance policies? Have the excess and umbrella been provided notice? If dealing with property, crime and even some liability policies, are there suit limitation clauses that might prevent action to recover insurance benefits? Do the policies in question call for notice or additional premium to the underwriter if there is a change in control of the policyholder? These questions are important to address during the due diligence process if an insurance recovery is counted on to offset an assumed liability.

4. Cooperate. As noted above, if there are pending insurance claims or liabilities, it makes sense that some written provisions in the deal documents call for cooperation and the availability of information to the party that will retain the insurance assets. Whether dealing with a business income claim or a product recall claim, it may be very important during the handling of the claim (especially if disputed) that access be given to business records, potential witnesses, and accounting or product information that might even post-date the merger or acquisition.

5. Consider "reps and warranties." An acquiring corporation may wish to secure written representations and warranties to the effect that all premiums have been paid, no retros or premium adjustments for the policies are due as of "x" date, the captive insurance companies are in good standing and are well capitalized, and all current policies are in full force and effect and have not been depleted or eroded through the payment of other (or unknown) claims. Representations and warranties may also be helpful for dealing with those potential threats that have not yet transformed into actual lawsuits. Thus, representations regarding notice of circumstances or potential claims provided to the insurance companies may also be useful in avoiding certain coverage defenses. ■

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