

# ANDERSON KILL POLICYHOLDER ADVISOR

The Policyholder Law Firm



## Insurance Due Diligence in Mergers, Acquisitions and Spin-Offs

By Mark Garbowski

Insurance policies represent a significant asset class that is often overlooked by the people who work on mergers, acquisitions and spin-offs. Insurance professionals — usually risk managers and attorneys — are an often overlooked human asset that can help their employers and clients protect themselves when making such deals.

### Insurance: A Matter of 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, 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 those of additional companies that were previously part of its corporate history.

Other research tools available to you are the legal research databases (LexisNexis and Westlaw) and Mealey's Litigation Report. 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?
- Are there high deductibles, front 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 are often 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?

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- 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?

The third step is an analysis that 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, with lots of defense costs and no indemnity
2. Moderate liability
3. Catastrophic or “bet the company” size liability

Using this information, your negotiators can make a far more intelligent decision about which liabilities to accept. 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. 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.

Your team also can 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 will never 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.

## Cleaning Up After the Fact

If you learn of the acquisition after the deal is done, you can still act 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.

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. ▲

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## About Anderson Kill

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 nonprofits 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.

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