PRESENTED AT

21st Annual Insurance Law Institute

November 10-11, 2016
Houston, Texas

Managing Key Insurance Issues in Corporate & Finance Transactions

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Introduction

In any contract for the sale of goods or services, contractual insurance requirements between counterparties are commonplace. Purchasers of services want to ensure that those performing labor have adequate liability and other insurance to protect against the risk to the purchaser, employees and third-parties associated with the scope of work at issue. Purchasers of goods likewise need the assurance that suppliers have the financial wherewithal to satisfy indemnity obligations and otherwise compensate for the risk of loss and liability arising out of the products at issue.

In other corporate and finance transactions, the risk and insurance considerations are different and correspond to the type of agreement and the interest of the parties involved. Lenders want the security for a credit facility appropriately insured. Lessors and lessees alike want real and personal property protected by insurance. Participants in a merger or substantive acquisition agreement will be concerned not only with coverage for the enterprise or assets exchanged in the deal, but will also focus on continuity and integration of insurance coverage going forward.

Nonetheless, the key insurance terms in a basic service or sale agreement provide a helpful framework for analyzing insurance considerations in more substantive corporate and finance transactions, including the following: (1) what type of insurance is required; (2) additional insured coverage and waiver of subrogation; (3) validation of coverage; (4) insolvency; and (5) anticipating claims handling.

What Type of Insurance is Required?

In a basic sale or service agreement, the purchaser will often require the seller/provider to procure and maintain specific types of liability insurance coverage with particular limits, including general liability, workers' compensation, employer's liability, commercial automobile liability, umbrella liability, and (depending on the nature of the service/product) errors & omissions or other specialized liability coverage. By contrast, the parties to a merger or acquisition agreement (and their constituent directors and officers) should pay attention to other critical details necessary to provide for continuity and optimization of liability insurance coverage.

In a merger or acquisition transaction, parties will have to address conceptually what risks may exist in the surviving organization, whether those risks will be retained, transferred or insured and what insurance will survive or may need to be placed in the future. A merger or acquisition may involve new operational or geographic risk that was not contemplated in the acquiring company's insurance program. Whereas the insurance terms in a basic procurement agreement may mandate coverage that is "primary and non-contributory" relative to other insurance maintained by a counterparty, in the aftermath of a merger or acquisition, risk managers will have to decide what existing policies will be retained and contribute to the surviving company's insurance program on a going forward basis. In some cases, the fundamental approach to addressing risk may differ from the acquiring company to the target, requiring a shift in strategy and integration of risk management personnel.

As a traditional means of addressing legacy risks and liability, parties will routinely require a six-year "tail" policy for D&O insurance (or other claims-made coverage) at closing for a merger or other transaction involving transfer of control of an entity. This is necessary because most D&O policies include "change in control" provisions, whereby a merger or other transaction transferring all or substantially all assets or "management control" of the insured organization will effectively terminate coverage for conduct occurring after the transaction is closed. Coverage under a tail will enable past and present insured directors and officers to have the benefit of coverage for claims made over the next six years for alleged "wrongful acts" committed prior to closing. The tail will collateralize ongoing indemnification and advancement obligations the surviving company owes to past and present directors and officers. Directors and officers will want a "single premium" tail policy so that the consistency of coverage will not be dependent on future payments from the surviving entity.

Whereas in an ordinary procurement agreement, the purchaser may require all insurance policies to be issued by licensed (or eligible surplus lines) insurance carriers with an A.M. Best rating of A-VII or better, the identity of the tail insurer remains important in a merger agreement. Sophisticated insureds will insist on placement of the tail policy with the same insurer providing the expiring entity's D&O coverage. While the existing carrier may be able to quote the best price for a tail, the real efficiency in this strategy comes in avoiding disputes between different carriers in the event of a claim—each one asserting that the other has liability for a claim arising out of the M&A transaction. There may be other benefits to the insured entity and individuals from maintaining coverage with one carrier.[1]

If the tail coverage is accomplished by endorsement to an existing policy, the insured organization must ensure that the surviving entity is identified as an "insured." It will be the surviving entity that ostensibly will seek coverage for a post-transaction claim. While a tail policy should never be construed to render its coverage illusory, including the names of both the predecessor and surviving entities may avoid disputes over which entity is entitled to coverage.

While a basic service agreement may include a provision requiring the insurers of all mandated policies to give prior notice to the counterparty prior to cancellation or modification of coverage, notice remains an important consideration in mergers and acquisitions. Many D&O and other policies require notice to the insurer of transactions involving a change in control. Moreover, not as a substitute, but as a compliment to a tail, prior to closing, insured individuals and

[1] *See, e.g.*, *Zenith Ins. Co. v. Commercial Forming Corp.*, 850 So.2d 568, 570 (Fla. Ct. App. 2003) ("[U]nless notice is given to the contrary, upon renewal of coverage by the payment of the new premium, the parties are entitled to assume that the terms of the renewed policy are the same as those in the original contract."); *Woodlawn Fraternal Lodge No. 525 v. Commercial Union Ins. Co.*, 510 So.2d 162, 164 (Ala. 1987) ("[T]he burden is on the insurer to notify the insured if the renewal policy differs from the original policy. Failure to notify the insured will result in the insured's being entitled to coverage under the policy as originally issued."); *Canadian Univ. Ins. Co., Ltd. v. Fire Watch, Inc.*, 258 N.W.2d 570, 575 (Minn. 1977) ("[W]hen an insurer by renewal of a policy or by an endorsement to an existing policy substantially reduces the prior insurance coverage provided the insured, the insurer has an affirmative duty to notify the insured in writing of the change in coverage. Failure to do so shall render the purported reduction in coverage void.").

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First appeared as part of the conference materials for the
21st Annual Insurance Law Institute session
"Managing Key Insurance Issues in Corporate and Finance Transactions"