Strafford Publications

"Insurance Issues In M&A Due Diligence"

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I. Who Involved in Insurance Should Be on the Due Diligence Team?

A. What is the value of the Risk Manager on the team?

B. Adding internal and external experts.

A. How Can Risk Managers Assist in Valuations and Mergers

1. If involved early, insurance professionals can add value.
2. Deal makers negotiate sharing of liabilities in a vacuum.
3. In determining whether or not to assume or refuse liabilities in a deal or whether the deal is worth it, availability of insurance must be analyzed.
4. Impact on acquisition price by risk managers' investigation and analysis.
5. How to sensitize decision makers as to the great value to be added by the risk manager.
6. Brought in late? What to do.

II. Knowing the Structure of the Insurance Program of the Company and the Merger Candidate Company

A. Information Gathering

1. Know what you know.
2. Know what you don’t know.
3. The time to get the information from others is when you have the upper hand – when interest in the deal is high.
    a. Competitive v. non-competitive acquisitions.

B. History of the Target Company's Insurance Program.

- What companies and lines of coverage have been added?
- What companies (possibly now spun-off) still can make claims under the target company's historic insurance program?

C. Historic Insurance Assets

1. Old policies must be reviewed for:
    a. Claims-made or occurrence-based?
    b. Aggregate limits/no aggregate limits.
    c. Related-corporation combined limits?

C. Historic Insurance Assets (Cont'd)

2. Old coverage programs must be reviewed for:
   a. Exclusions.
   b. Limiting Clauses: deemer or non-cumulation.
   c. Erosion.
      - Toxic tort claims, asbestos claims environmental clean-up claims, product liability claims.
   d. Settlements and Commutations.
   e. Claims-made coverage conversion.

D. Identifying and Analyzing Gaps in Coverage

1. Retrospective premiums.
2. Fronting policies.
3. Insolvent insurance gaps.
4. High deductibles.
5. Captives.

D. Identifying and Analyzing Gaps in Coverage (Cont'd)

6. Trigger: First exposure data.
7. What state's law likely will govern application of the liabilities to the coverage?
8. How are "gaps" dealt with?
9. What is cut-off period for allocating liability?
10. Are liabilities applied to a year in excess of coverage?
11. How many occurrences are applied?
12. How many deductibles are applied?

E. Understanding New Potential Liabilities

1. Form of the transaction (statutory merger, asset purchase, de facto merger, etc.)
2. Corporate successor liability issues
   a. Leading cases (*Henkel, Del Monte*, etc.)
   b. Consent to assignment issues
3. Additional insured issues/exposures
   a. Analysis of AI endorsements
   b. Implications for Limits
4. Analysis of historic claims/liabilities – knowing what you are buying
5. Insurance products available to address potential gaps

F. Evaluating the Claims Experience of the Target Company

1. Review and Analysis of Loss Runs.
   a. Loss runs received. Understanding them.
   b. How is the target company reporting them?
      - What is its reserving practices?
   c. What are the reporting guidelines?
   d. The red flag of internal v. external administration.
2. Evaluation of reported liabilities and analysis of different types of liabilities reports

F. Evaluating the Claims Experience of the Target Company (Cont'd)

3. IBNR.
4. Anticipated future claims.
5. Breaking down your analysis regarding long tail claims.
    a. Separate each area of long-tail liability: environmental clean-up, toxic torts, product liability, etc.

G. Use Multiple Scenarios for Modeling

1. Best Case: Nuisance claims, lots of defense costs and no indemnity;
2. Most Probable: Moderate liability; and
3. Worst Case: Catastrophic liability, “bet the company” liability.
    a. Perform modeling scenarios with respect to various categories of potential claims (asbestos, environmental, directors and officers)
    b. Allocation analyses (“all sums,” pick and choose, *pro rata* time on the risk, joint and several liability)

H. Allocation of Premiums

1. Allocation by business unit.
2. Impact on business plan.
3. Expectation by business units.

I. Impact of Contract Indemnification Language on Insurance

1. Standard contracts with suppliers and vendors.
2. Contractual Liability Coverage.
3. Educating the sales force.
4. Handling rogues/Internal audit.

III. Extracting Value

A. Evaluate return premiums due.

B. Extract investments in captives.

IV. Using Your Analysis

A. Providing advice as to how to structure the deal with liability and insurance information in hand.

   1. What price reduction should you demand?
   2. What is your risk tolerance?
   3. Identifying positive insurance assets that could be brought in.

B. Consider structured indemnities, finite risk vehicles, captives, special purpose insurance.

V. Questions & Answers