

Top 10 Things Corporate Attys Should Know About Insurance

By William Um and Erica Dominitz, Kilpatrick Townsend & Stockton LLP

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This article is a follow-up to a previous article by the authors, Top 10 Things Litigators Should Know About Insurance.

Almost every corporate transaction — mergers, purchase and sales, real estate matters, among others — involves some “insurance” related issues. They can range from simple “insurance requirements” in the corporate documents to more complicated issues involving the assessment and valuation of insurance assets as part of the due diligence process. All too often, however, insurance issues are overlooked because corporate lawyers are focused on other aspects of the deal.

In doing so, corporate attorneys may be overlooking — or inadvertently jeopardizing — valuable insurance assets that could impact the value of the transaction. To better understand these risks and to avoid future economic surprises, corporate attorneys should have some basic insurance knowledge as they guide their clients through transactions.

This article provides insurance tips that should be considered well before the deal documents are signed.

1. Don't Lose Control of Your Existing Insurance — Review and Comply With “Change in Control” Provisions and Requirements in Your Existing Insurance Policies.

Many insurance policies — usually director’s and officer’s liability policies — contain “change in control” provisions that require an organization to provide the carrier with notice, within a specified time period, of certain, enumerated types of corporate transactions or other events that will result in a change in majority ownership or control of the entity. Policy forms vary as to what types of events are deemed a “change in control,” but often include events such as a merger, acquisition or a change in individuals or entities with the right to elect more than 50 percent of the board of directors, among other things.

These provisions also specify how the transaction will affect coverage. Some policies state that coverage will continue until the policy’s termination date, but only for claims made and reported that arise from alleged conduct (or, in D&O policy parlance, alleged “wrongful acts”) that took place prior to the transaction or change in control. Other policies, by contrast, state that coverage under the policy will



William T. Um



Erica J. Dominitz

terminate altogether on the date of the transaction or change in control.

Companies engaging in transactions that will lead to a change in control often elect to purchase extended reported period coverage, which also is referred to as run-off coverage or “tail” coverage, and is discussed below.

2. Should You Purchase Reps and Warranties Coverage for Your Deal?

Critical to a buyer’s evaluation of an acquisition is the allocation of exposure between them with respect to unknown risks and liabilities, which are captured in various forms of representations and warranties expressed in the deal documents. Representation and warranty insurance is designed to protect the policyholder, typically the buyer (but also is available to sellers), from losses resulting from unintentional and unknown breaches of a seller’s representations and warranties.

R&W insurance could reduce or eliminate the need for sellers to maintain reserves or provide collateral for contingent liabilities, and thus increase the deal value for the parties. In some instances, it could make the difference between whether a deal gets done at all. The specific “loss” covered by R&W insurance should be structured to mirror the purchase agreement so that the policy will cover losses the seller would be required to cover under the purchase agreement. R&W insurance will not protect against all losses related to representations and warranties because the policy will insure only unknown claims, but R&W insurance can extend or backstop an indemnification obligation in the transaction. In some transactions, R&W insurance might end up being the buyer’s sole source of recovery in the event of breach by the seller.

3. “Insurance Requirements” in Deal Documents and Insurance Due Diligence

The seller’s insurance policies are valuable assets, the transfer of which should be included in the deal documents. The deal documents should provide a complete list of all policies to be conveyed or transferred, and also should represent that all premiums have been paid, that the policies are valid and enforceable and remain in full force and effect, and that they will be renewed on the same terms if their renewal date precedes the date on which the deal documents are executed.

In order to maximize the benefit, or to at least understand the value, of these assets, the buyer should engage in thorough due diligence that analyzes the seller’s liabilities as well as its available insurance coverage for such claims. When considering liabilities and exposures, it is important to review historic claims, as well as pending claims and exposures, to fully understand the company’s risk profile. The seller should be able to furnish copies of loss runs, which should reflect all claims reported under the historic policies.

The buyer also should analyze the seller’s historic and current policies. They should consider the amount of available insurance limits, the scope of available coverage, and any other provisions that might impact the value or availability of benefits. While some people (often incorrectly) assume that older insurance policies have “expired,” policies that provide occurrence-based coverage, rather than claims-made coverage, typically are triggered by loss or damage that took place during the policy period regardless of when a claim is filed against the policyholder, and therefore, can provide coverage for current claims based on alleged historic activities and harm. In other words, they are gifts that keep on giving. It is important, however, to consider whether there are other reasons why these older policies might not be available to cover future claims, such as whether they have been fully exhausted by payment of prior claims or have been released by settlements.

4. Review Insurance Policies' Anti-Assignment Provisions

Companies should analyze whether their transaction could affect their ability to access coverage under historical insurance policies. Even when the transaction documents explicitly state that the seller's historical insurance rights and assets are to be transferred to the buyer, the parties should be aware of insurance provisions and state laws impacting the ability to transfer the insurance assets and rights. Carriers often argue that so-called "anti-assignment" provisions in their policies relieve them of coverage obligations when insurance assets or rights have been assigned without their consent.

Typically, a constituent company's rights to insurance coverage automatically vest in the surviving company by operation of the relevant state merger statute, without implicating the anti-assignment clauses in the policy. However, absent statutory transfer, courts are split over whether anti-assignment provisions are enforceable. Fortunately, the majority rule is that anti-assignment clauses do not apply to claims arising from injuries or occurrences that occur prior to the assignment or transfer of policy rights, and therefore do not bar coverage for post-loss assignments of coverage assets or rights. The rationale for this approach is that pre-assignment losses or occurrences do not increase the carrier's risk profile.

Nonetheless, a handful of states, including Hawaii and Oregon, still require consent from a carrier before policy rights can transfer. Therefore, companies should consider what state's law likely will govern the insurance policies and should obtain consent to the assignment or should structure the transaction in a manner that is least likely to jeopardize the buyer's rights under the policies.

5. Obtain Complete Copies of Policies (Not Just Declarations Pages)

Companies undertaking transactions should be sure to request — and, of course to review — complete copies of the various policies that will transfer to them as a result of the transaction, rather than just copies of the declarations pages. While the declarations pages provide important information about the coverage, such as policy limits, sublimits and retentions, they provide an incomplete picture of the amount and scope of coverage. For one thing, sometimes carriers modify a policy's limits, sublimits and retentions through endorsements, so they need to be reviewed as well. Moreover, it is important to review not just the amounts of coverage but also all terms and conditions to understand the scope of coverage available, requirements regarding when and how to provide the carrier with notice of certain events (including notice of potentially covered claims), and of other benefits that may be available (such as a reduction in premiums for early reporting of claims and potential claims). While this is an important exercise with respect to all policies, it is particularly important with respect to D&O policies, cyber policies and other typically nonstandardized policies, whose terms tend to vary quite a bit from policy to policy.

6. The Differences Between "Named Insureds" and "Additional Insureds"

It also is important to understand whether your company is, or will be, a "named insured" or, alternatively, an "additional insured" under the relevant policies as different rights and responsibilities flow from these different statuses. Named insureds typically have the broadest rights but also are subject to more requirements than additional insureds.

For example, the "named insured" typically is responsible for paying premiums, requesting changes to policy language, providing notice of cancellation, accepting notice of cancellation or returns of premiums, among other things.

Those added to a policy as an “additional insured” should carefully review the policy to understand the scope of coverage provided to it because coverage for additional insureds often is more restrictive than that available to named insureds. For example, some policies specify that additional insureds are covered only for claims alleging liability that is derivative of the named insured’s alleged liability. Also, some policies state that the coverage available to additional insureds is excess of any other insurance available to them. It therefore is important to make sure that the scope of coverage actually provided to additional insureds is consistent with their expectations and, if not, to negotiate for broader coverage. This underscores the importance (discussed further above) of making sure that complete copies of insurance policies, rather than simply declarations pages or certificates of insurance, are reviewed during the due diligence process.

7. Protect Your D&Os From Personal Liability — Side A D&O coverage

Corporate attorneys regularly interact with company executives and board members and often are asked about the scope and sufficiency of D&O insurance. Directors and officers no doubt will want to ensure that the company’s — and their own — liability is adequately protected.

First, a quick primer on D&O insurance. D&O insurance typically provides three (or more) distinct coverages: (1) “Side A” is coverage for individual directors and officers of the organization for claims asserted against them for which they are not indemnified by the organization; (2) “Side B” is corporate reimbursement coverage for organizations that indemnify their directors and officers for claims asserted against them; and (3) “Side C” is coverage for the organization for securities-related claims asserted against the organization. Not surprisingly, individual corporate officers and board members often are most interested in knowing the scope and extent of Side A coverage.

Side A covers losses that are not indemnified by the company, which is relatively rare but could occur when: (1) the entity is financially unable to indemnify its directors and officers (e.g., when the company is in bankruptcy); (2) the defendant directors and officers must pay a settlement or judgment in a shareholder derivative lawsuit; or (3) when the company is not permitted to indemnify, either by its bylaws or applicable statute, a claim made against the individual directors and officers. To guard against these potential risks, companies should consider purchasing Side A only policies for its directors and officers. These policies provide excess limits in the event the limits under the primary policies are exhausted by other claim payments and defense costs, and these policies are designed to “drop down” over primary D&O policies in the event that an exclusion or other coverage restriction applies.

8. The Interplay Between Insurance Requirements and Indemnification Provisions

Most commercial contracts contain some form of indemnification requirement whereby one or both parties agree to indemnify the other for liabilities that might arise from each other’s conduct covered by the contract. In addition, these commercial contracts contain “insurance requirements” whereby the parties are required to secure appropriate insurance — typically liability insurance — for the benefit of the other party for the conduct covered by the contract. So what is the interplay between the indemnity and insurance provisions? One description is that the indemnity and insurance requirements act as “belts and suspenders,” whereby if the indemnity “belt” fails, the insurance “suspenders” will keep your pants up.

While insurance is often considered a “backstop” to indemnity, it does not necessarily follow that the scope or nature of the insurance protection is directly aligned with the indemnity obligation. In some

instances, insurance can provide protection under terms that are either broader or narrower than that provided under the indemnification provision. Moreover, there is no express requirement that a party first pursue indemnification and instead, in certain circumstances, the indemnitee might prefer to bypass the indemnitor and seek direct protection from the carrier.

9. Submit Notices of Circumstances and Buy Tail Coverage

As mentioned above, when there is a “change in control” due to a merger, acquisition or some other event or transaction, the policy period will soon terminate and the policyholder therefore must take immediate action. One recommended strategy is to provide notice of facts and circumstances that may lead to a future claim. If done properly (i.e., consistent with the policy’s requirements) and a claim subsequently is asserted, the future claim will be deemed to have been made at the time notice of circumstances was provided, thereby triggering coverage under the terminated policy.

Alternatively (or even additionally), policyholders should consider purchasing tail coverage or “extended reporting period” coverage. The extended period could vary from several months to several years, and, if purchased, then coverage otherwise afforded by the terminating policy will be extended to apply to claims involving alleged wrongful acts that occurred prior to the termination date of the original policy and that are first asserted during the extended reporting period. Because claims typically are not asserted until several months, or even years, after the alleged wrongful acts occurred, corporate attorneys should assess the type of potential claims that could be brought and the applicable statutes of limitations, and advise their clients to consider tail coverage to protect against such future claims that otherwise would not be covered under the terminating policies.

10. Coverage for Shareholder Lawsuits Regarding the Transaction

Of course, after spending a lot of time, effort, and money in connection with planning a corporate transaction, many companies find that they are “rewarded” by ensuing shareholder demand letters and lawsuits alleging breaches of fiduciary duty and aiding and abetting fiduciary breaches in connection with the transaction. These demands and lawsuits often are made and filed as soon as the parties announce the proposed transaction. Be sure to put your carrier(s) on notice of these demands and lawsuits. In fact, many attorneys who represent shareholders in these types of lawsuits often file press releases or send demand letters in advance of filing a lawsuit. It is a good idea to put your carrier(s) on notice as soon as you receive some indication that a shareholder lawsuit (or other lawsuit) is being contemplated — particularly if it is close to the end of the policy period — which typically is referred to as providing notice of circumstances that may give rise to a claim, the requirements for which are addressed in most, if not all, D&O policies (as noted above).

While some of the plaintiffs’ allegations arguably might implicate policy exclusions, the carrier should have defense-related obligations if there is any possibility that at least some of the claims might be covered. While the terms of each potentially applicable policy must be reviewed to assess the scope of coverage provided, we note that most policies have, and carriers typically reserve their rights regarding, exclusions for intentional violations of law and for dishonest, fraudulent or criminal conduct, and for obtaining a profit or advantage to which the policyholder was not entitled. While the specific language of the exclusions should be closely examined, many policies state that such exclusions apply only if there is a final adjudication proving such conduct.

Additionally, some carriers assert that there is no coverage for disgorgement or other categories of damages plaintiffs often seek; however, many policies do not even contain such exclusions. Again, while

coverage will turn on the specific facts and circumstances surrounding the underlying claim and the particular policy language at issue, it is important to evaluate any coverage defenses asserted by the carrier, and to challenge positions that seem unfounded.

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Insurance creeps into many facets of the law, and transactional work is no exception. Corporate attorneys should have a basic understanding about the insurance related issues discussed in this article to better guide their clients through different corporate transactions.

William T. Um is an attorney in the Los Angeles office, and Erica J. Dominitz is an attorney in the Washington D.C. office, of Kilpatrick Townsend & Stockton LLP.

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