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Insurance Due Diligence

The Need for Insurance Due Diligence

Insurance is a corporate asset and deserves as much attention and review as any other company asset in connection with a merger, acquisition or investment. Understanding a company's insurance program is necessary to assess risk associated with an investment in that company. If the amounts, terms, quality or types of insurance are inadequate, the asset is impaired and risk is increased. A company's insurance also is a factor in determining whether it is adequately capitalized for purposes of a veil-piercing analysis. For these reasons, due diligence into a target company's insurance program should be part of any merger, acquisition or substantial investment.

The majority of Insurance Due Diligence work is performed by brokers. But their work is not privileged, as is the case when Insurance Due Diligence performed by a law firm such as Pillsbury. And it has been observed that brokers often have conflicting interests when they are either the incumbent broker (with an interest in preserving that status), or hoping to become the broker. Retention of Pillsbury solves that problem, in most cases. In addition, our focus is much broader than a broker's. Unlike an insurance broker, we focus on critical legal issues, including ensuring that the benefits of insurance policies are properly transferred , designing runoff or tail coverage, structuring coverage to match the terms of the transactional documents, assessing pending claims, evaluating whether potential claims have been properly reported and whether they are adequately insured.

What Does Insurance Due Diligence Involve?

The following is a brief outline of what Insurance Due Diligence entails:

I. Understand Target Business and Identify all Relevant Insurance Policies

— Review and analyze business profile (i.e. SEC reports, financial statements, annual reports, bylaws, market reports, minutes, etc.) to identify key risks.

— Obtain all relevant insurance policies for review (i.e. General Liability, Property, Directors & Officers, Auto, Worker's Compensation, Professional Liability, Environmental, captives, etc.).

— Check current insurance programs against list of coverages deemed customary or standard for industry.

II. Summary and Structure of Insurance Policies

— Review key coverage terms and conditions, including limits of liability, self-insured retentions (SIR), policy period, retroactive date, named insured, and exclusions for appropriateness to risks.

— Summarize key policy provisions, including insuring agreements, key definitions, key exclusions; key conditions, reporting of claims.

— Identify potential issues or gaps in coverage or suggested wording changes.

— Benchmarking against peers in relevant industry.

III. Claims Exposure Assessment

— Identify and analyze pending claims (valuation, assessment of potential exposure, coverage analysis), whether properly reported, status of defense/coverage position taken by insurers, and applicability of coverage to offset exposure.

— Availability of coverage under legacy insurance policies, and analyzing requirements to transfer coverage rights in transaction.

— Assess risk management for future claims (risk management programs, coverage analysis, valuation, etc.).

IV. Risk Management/Brokers

- Evaluate current broker relationship and role of other relevant professionals (e.g., auditors) addressing risk or claim management
- Assess current broker arrangements (i.e., Fees/Compensation, Client Service Agreements/Placement Agreements, services provided).

V. Special Directors & Officers Insurance Issues

- Evaluate whether change-in-control provisions will result in automatic termination of coverage
- Identify whether tail coverage is needed
- Identify potential cost savings through harmonization of companies' insurance programs
- Determine whether independent director liability coverage is needed by representatives of the acquiring company.

VI. Anti-Assignment Provisions

- Will the insurance follow the liabilities?
- Analyze the impact of anti-assignment provisions and determine whether there are work-arounds.

VII. Insurance Products to Facilitate Transactions

- Consider mitigating risks through representation and warranty insurance, tax liability insurance, litigation insurance, and cost cap insurance.

What Should You Do?

Involving Pillsbury's Insurance Recovery and Advisory practice in your due diligence process gives the legal team greater control over the quality of information and analysis generated through Insurance Due Diligence. It eliminates the bias inherent in outsourcing this work to brokers, and ensures that appropriate legal scrutiny will be brought to bear on the target company's claims history and the adequacy of its insurance coverage.

About Pillsbury

Pillsbury Winthrop Shaw Pittman LLP is an international law firm with offices around the world, and a particular focus on the technology, energy & natural resources, financial services, real estate & construction, and travel & hospitality sectors. Recognized by legal research firm BTI as one of the top 20 firms for client service, Pillsbury and its lawyers are highly regarded for their forward-thinking approach, their enthusiasm for collaborating across disciplines and their unsurpassed commercial awareness.

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