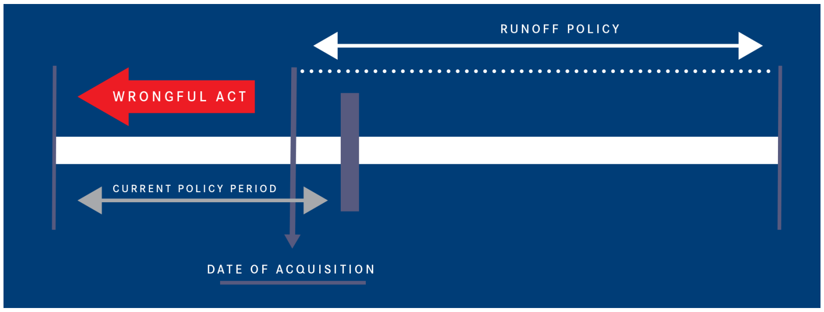
U.S. Risk, LLC

M&A COVERAGE CONSIDERATIONS

The acquisition or sale of a company may bring opportunities but can also raise complex insurance issues, potentially disrupting several forms, including Directors & Officers Liability (D&O), Employment Practices Liability (EPL), Fiduciary Liability, and Cyber/Errors & Omissions (E&O) Liability.

Insurance protections must be properly planned for prior to the event so that coverage is in place during the time of the merger or acquisition —and, for those events that could continue on even after the deal is closed.



IMPORTANT RUNOFF POLICY CONSIDERATIONS

A Runoff policy covers what would otherwise be a gap in coverage for directors and officers after the sale of a company and is most frequently purchased when the insured is being merged or acquired and will not be the surviving entity. The intent is to cover future claims made during the Runoff period arising out of conduct by the directors and officers prior to the acquisition. Some of the key policy and purchase considerations include:

› Change in Control Provisions

When a change in control provision is triggered, coverage under the policy changes, typically covering acts and omissions which occurred in the regular course of business, but not those after a change in control when circumstances have been altered. When the triggering event occurs and the coverage terminates, the policy is placed into run-off. It is important to understand these nuances of the change in control language before any deal, especially because once the provision is triggered, it can create unintended gaps or even eliminate all D&O coverage.

› Merger Objection Claims

This is the most common type of claim during an acquisition. Many are shareholder suits claiming breach of fiduciary duties by the target company's board of directors in approving the sale of the target. As merger objection lawsuits grow, so do the efforts of insurance companies to resist or reduce coverage for these lawsuits. Great care should be paid to reviewing and seeking appropriate clarification of exclusions in current D&O policies.

› Representation and Warranties

Discrepancies in the manner in which each company represents itself during a merger or acquisition can cause significant liabilities after closing, and those liabilities may not be covered by a company's current policies. Representation and warranties insurance can protect against unknown and unintentional breaches of the various documents and agreements that make up the M&A.

RUNOFF COVERAGE TIPS

Discuss the need for coverage while the deal is still pending. *This should include the length and cost, as well as who will be responsible for paying for the coverage.*

Understand the impact of length of coverage. *Runoff coverage is typically necessary for three to six years. As statute of limitations may vary depending on allegations, a longer term is often suggested. With this, the financial stability of the insurer becomes of critical importance.*

Check on return premiums. *If the company is staying with the same insurer, the unearned premium will often be credited against the additional premium. If the coverage goes to a different insurer, a return premium on the program in force should be requested prior to the deal closing.*

Pay attention to limits. *The Runoff period is typically an extension of the current policy's aggregate limit. But if there are any potential claims that could erode the runoff limit, seek either a new limit or add additional limits.*

Review change in control provisions. *Before any merger or acquisition, it is crucial to review and understand any change in control provisions and corresponding notice requirements to keep the intended insurance in place, uninterrupted, or secure new coverage.*

Add a 'successor in interest' endorsement to the Runoff policy *when the indemnification obligation transfers to the buyer to ensure the buyer receives the benefits of the Side B coverage. The insurer should not add the buyer as an insured on the Runoff as this could create insured. vs. insured exclusion issues.*

Ask for straddle wording. *When a claim includes a series of alleged acts, some occurring before and some after the transaction, it may cause confusion about how directors and officers are covered. These are called straddle claims. Specific policy language within the wrongful acts section can address these claims.*

M&A COVERAGE CONSIDERATIONS

› Responsibility for Premium Payment

Often merger agreements cap the cost of the tail coverage with the intent to limit the cost paid for the tail policy. This can cause issues because the insurers providing the tail insurance are not bound by the merger agreement – they will charge the amount they feel appropriate for the risk even if it exceeds the cap. If a premium cap is set too low, a target company may be forced to purchase less insurance or reduce the breadth of coverage, to comply with the merger agreement. As the insured under the tail policy, it is imperative the target company's directors and officers consider what in their best interests as this insurance may be the only protection available should indemnification not be available from the acquirer.

› Length and Costs of Coverage

Runoff coverage is typically purchased for a six-year duration and the coverage is generally priced as a percentage of the existing annual premium (often ranging from 200-300% of the annual premium).

THE BOTTOM LINE

Plan early is the watchword for merger and acquisition insurance. Merger and acquisition deals can be complex when it comes to coverage. It is important to understand how both the buyer's and the seller's policies will respond to this event and to secure all necessary coverage at the outset. Those considering a merger or acquisition need a highly skilled and trusted insurance expert brought into the process as early as possible.