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Lawyer Insights

Overlooking Insurance During Mergers Brings Hidden Dangers

By Syed Ahmad, Adam Lyons, and Alex Pappas
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In the intricate world of mergers and acquisitions, the journey towards seamless integration often overlooks insurance—an essential consideration. Neglecting insurance can create unexpected financial exposure that could impact an acquirer's financial security.

To avoid falling into insurance-related traps, organizations engaged in M&A should consider how the transaction form, the specific policy, and applicable state law affect their insurance assets, particularly with respect to continued coverage under the policies of an acquired business.

Organizations involved in M&A often inherit a complex web of policies from the target business that influence availability of post-transaction insurance coverage. Some insurance policies may contain specific change-in-control provisions that delineate exactly what happens in a merger or acquisition.

Other policies offer less guidance and merely contain short anti-assignment provisions that prohibit the transfer of a policy by a named insured to another entity unless the insurer consents in writing. The wording of anti-assignment provisions can determine the availability and scope of go-forward insurance coverage.

What to Look For

Specific provision language must also be considered in the context of the form of the M&A transaction being considered. For example, the legal and practical effects of anti-assignment provisions may be different for statutory mergers than for asset purchases.

Statutory mergers are a common way to transfer insurance assets. The process for this involves a surviving entity that succeeds to ownership of the rights, assets, and liabilities of the merged entity under state-specific statutory requirements. Mergers under the Delaware General Corporations Law are a familiar example. In this context, many courts have overridden policy anti-assignment provisions because the surviving entity inherits all the acquired entity's assets by operation of law instead of by contract.

Insurance assets can also be transferred via asset purchases. Acquisitions by asset purchases involve one entity's purchase of specific assets of another entity via contract, where the assets being acquired are specified in the purchase and sale agreement.

Many courts have been particularly reluctant to override the express terms of anti-assignment provisions in this context, which generates extra insurance-related exposure. Especially in this context, the prospective continuation of coverage under acquired insurance policies often may hinge on applicable state law.

As with most insurance coverage questions, governing state law is especially important and can even be outcome-determinative. Which law governs is itself often the subject of dispute. For example, depending on the circumstances, the applicable law could be of the state where the loss occurred or where the policy was issued.

Because choice-of-law issues can be dispositive, acquirers should carefully grapple with the effects that applicable law may have on acquired insurance assets before finalizing a transaction. This will help identify any potential gaps in continued coverage so those gaps can be addressed before closing. Ignoring these considerations may lead to substantial coverage gaps that can leave the acquiring organization financially vulnerable to potential uninsured losses.

Protecting From Risks

To mitigate the risks of insurance coverage gaps, a proactive approach during the transaction diligence process is essential. Insurance policies are often highly individualized and subject to negotiation that can lead to marked departures from standard policy terms.

A proactive approach may involve partnering with insurance counsel who can analyze policy terms, assess their compatibility with the transaction, and recommend adjustments, as necessary. By addressing potential insurance issues early and often, organizations can address any potential coverage gaps before they become liabilities.

Considering insurance early in the transaction process is usually better than waiting until a claim is made or an insurer denies coverage. Upfront consideration can help avoid unexpected coverage gaps, and ensure that an entity’s insurance strategy adequately supports an acquirer’s growth trajectory. Proactive insurance reviews can also allow policyholders to seek favorable policy terms, including potential exceptions to anti-assignment provisions.

Successfully navigating an M&A transaction requires a holistic approach that encompasses insurance considerations, among many other diligence items. If insurance is overlooked, hidden dangers may expose an acquiring organization to coverage denials that could sink the possibility of substantial insurance recoveries.

By being proactive about insurance issues, organizations can avoid coverage gaps and associated financial vulnerabilities. M&A transactions are diverse, and each type warrants a tailored insurance strategy. With thorough due diligence and expert guidance, organizations can confidently move forward knowing that their insurance goals align with the contemplated transaction.

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