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THE INSURANCE NEWSLETTER

Spring 2015

Insurance Due Diligence

Some of the most important services we can offer you take place at times of major changes in your business. Mergers, acquisitions and divestitures are major transactions with many important details that must be attended to, in any size deal. Often overlooked is the way these transactions can affect your insurance program.

The professionals you'll work with most in these transactions are your attorneys, accountants and bankers. Remember, though, that insurance policies are a significant asset class, and they are usually poorly understood and often overlooked by these folks. Insurance professionals are an important professional resource, and we can help you protect yourself when making such deals.

When contemplating these transactions, and especially when considering an acquisition or merger with another organization, step one for us will be to ask your negotiating partners to provide current and historical insurance policies and loss history data. This can often be more complex than it might seem, especially when your target is or was a subsidiary or branch of a larger entity. In such cases applicable coverage might be provided under multiple insurance programs: its own program maintained by the subsidiary or branch that is your target, its parent's program, and possibly those of additional companies that were previously part of its corporate history.

We'll want to get as much of this information as soon as possible. Once in hand, we'll start by analyzing the policies and information provided. There are a number of specific areas we'll be looking into. The list is long, but some of the most important items we'll look at would include:

- Are any liability policies claims-made or occurrence based? For any claims-made policies, have any notices of circumstances or potential claims been given? How much of an extended reporting period is included with each policy; will it be worthwhile or necessary to purchase an additional extended reporting period, extended discovery period, or even a special policy to cover new claims that arise from past pre-transaction activities?

- Are there any loss sensitive plans, retrospective premium programs, high deductibles or other alternative financing plans? Do we have the plan documents that should go along with the insurance policy itself for these plans?

- What has the claims experience been within these plans? Have any plans for any years made any progress toward reaching any applicable maximums on retrospective or deductible plans? Who will be responsible for future premium adjustments arising from these plans?

- Are there claims that have been made against any policies that might have eroded or exhausted limits?

- Are there any unusual or highly specialized policies in the program? Are there any policies written by excess or surplus lines (non admitted) insurance companies? Why?

- Do any policies have any unusual exclusions or limitations? These are sometimes added by insurance companies in response to extreme or unusual exposures or claims, and could be a red flag pointing to undisclosed liabilities.

- Is any part of the historical insurance program with insolvent insurance companies, or companies whose long-term financial viability is in doubt?

- What has the overall claims history been like? How does it compare to norms within that industry? What is the workers compensation experience modification? Poor experience can often be a reliable indicator of management inattention or indifference, which would be a clue to look for other problems elsewhere.

Other questions will likely arise from this work. Some examples:

- Do we have access to the seller's insurance program for recent years? Who handles late arriving claims for years prior to the deal? If we ever makes claims under the seller's policies, who pays any resulting deductibles or retrospective premiums?

- If the target's insurance program was claims-made, should your company give notice of any potential claims before the end of the current policy period?

- Are there any premium refunds or adjustments due? Bear in mind that while it may be relatively easy to agree to pay or receive deductibles or retrospective premiums, as a stranger to the seller's insurance program, we'll probably never know with certainty whether any premium or cost allocation is fair or not.

The next challenge we'll face is to see how the newly acquired organization will fit into your existing insurance program.

- Are you merging with or acquiring an entity with operations the same or similar to yours? That might be an easier insurance match and allow the target to fit easily into your insurance program. Is the target in a different field or business? That can present complications; it might be necessary to approach an entirely different set of underwriters to obtain coverage.

- Can we expect to obtain assignment of any policies currently in force at the target company? Will underwriters agree to continue their policies after the deal is done? When do those policies expire; how much time do we have to plan for renewal or replacement coverage?

- What kind of claims activity can we expect? Are we likely to see many nuisance claims with lots of defense costs but few claim payments, are we concerned with catastrophic or "bet the company" size risks, or something in the middle? What kind of impact will this have on our current insurance program?

- And related, what will happen to our workers compensation experience modification? Rating bureau rules generally require all of the target's prior premium and claim experience be melded into our modification on the date the deal closes; will this be a good or bad thing for us?

- How well can we expect the target organization to fit into our existing loss prevention and claims management programs?

As you can see, handling the transition of an insurance program, even in relatively smaller transactions, can involve a lot of work. Its unfortunately not uncommon that we'll learn of an acquisition close to closing or sometimes only after the deal is done.

When that happens we'll need to take quick action to minimize any negative effects on your program and assure an orderly assumption of the new operation. One of the first things we'll want to do is to find any long-time employees of the company you acquired who were involved in or knowledgeable about any relevant insurance programs. We'll want to do this quickly, before any planned downsizing and before such individuals might leave of their own volition. Once such individuals are identified, we'll want to debrief them on where any old policies, claims files or the like might be found, details of the history of the insurance program, names of prior brokers or insurers, and any other relevant questions. We'll want to have the same types of conversations wherever possible with prior brokers and possibly prior insurance companies.

Remember, unless you make any arrangements to the contrary, if you're sued for any alleged pre-transaction liabilities of the company acquired, you'll want to push those claims back to the seller. We must send notice to all of that company's historic insurance companies that you have found. You should also send a letter to any prior owner of the company you acquired - not just the company that sold it to you - and demand that they put all of their relevant insurance companies on notice of these claims immediately. This can sometimes be an issue, since it might put your company in competition with the prior owners of the acquired company for insurance assets. Where two companies are claiming under the same policies, there may be no problem if the policies do not have aggregate limits applicable to the claims. However, where there are applicable aggregate limits, assume you are operating under a "first come, first served" rule.

To summarize, remember that the insurance program of any targeted acquisition or merger partner is an asset. You'll want a knowledgeable team to perfect your interest in those assets; that's where we can help you. Please involve us as early as possible.

Cyber Coverage for Fines & Penalties

As a general rule insurance policies won't provide coverage for legal or regulatory fines and penalties imposed on a policyholder. Regarded as a punishment for some violation or shortcoming, these have generally been considered not insurable by underwriters. In many jurisdictions they might also be deemed uninsurable as a matter of law, precedent or public policy.

Cyber insurance is different, in a way that really enhances its value to those with this exposure. As we have previously pointed out, a wide assortment of different regulatory authorities, both public and private, assert jurisdiction over some aspect of data privacy, data security, and network vulnerability. One of the (often significant) direct costs a breached organization will incur is the costs of a governmental or regulatory investigation, and resulting costs of fines and penalties that might be assessed or imposed by one or more of these authorities.

A variety of governmental agencies have the ability to investigate data security breaches and to issue fines and penalties. Here are a few examples:

- The Federal Trade Commission has used its power under various statutes to regulate unfair or deceptive acts relating to data security. The FTC is also actively lobbying Congress for more authority to impose civil penalties for data breaches.

- The U.S. Department of Health and Human Services and state attorneys general enforce the penalty provisions of HIPAA, under which penalties can be millions of dollars for data breaches relating to protected health information.

- The Federal Communications Commission has levied sizeable fines for violations of the privacy requirements of the Communications Act of 1934.

- State attorneys general (sometimes working together) actively investigate data breaches and may impose fines or penalties.

The good news is that many cyber policies will cover fines and penalties. Common conditions for such coverage to attach would specify that the fines or penalties must be imposed by a governmental agency, they must be paid to a governmental entity or a consumer redress fund, and they must be insurable under applicable law.

To this last point, insurance policy language may expressly grant coverage for fines and penalties, but there is always a question as to whether such items can legally be insured. The answer to this question depends on laws applicable in each specific jurisdiction and on the specific circumstances of each case. There is no single right answer, but some general observations are possible. Fines or penalties that are based on findings of intentional or willful misconduct are likely to be challenged based upon public policy arguments. Those that might be more generally regarded as punitive in nature (intended as punishment for some conduct) are more likely to be challenged than those that are compensatory in nature. Penalties that are assessed vicariously against a policyholder (such as when a corporation is held liable for an unauthorized act of its employee) are less likely to be challenged.

It is also important to note that policies that provide coverage for cyber related fines and penalties typically will also provide coverage for costs incurred in connection with related governmental or regulatory investigations and pursuit of claimed violations. This will typically be a coverage grant that covers legal fees and other costs associated with a "Regulatory Proceeding", usually defined as an action by one of the above listed agencies or commissions.

Costs for investigations and defense arising from these proceedings can be substantial, so this coverage can also be quite beneficial. It also is important to realize that defense and investigatory costs are not subject to the question of insurability mentioned above, so even if any ultimate fines or penalties do undergo such scrutiny, these expenses can still be paid.

Insurance for certain fines and penalties imposed as a result of privacy breaches is widely available and can be a useful part of a cyber risk mitigation plan. Likewise, coverage for the defense and investigative expenses incurred during a regulatory action also can substantially defray the economic impact of a breach. However, coverage for fines and penalties involves questions of law regarding insurability that can not be directly addressed in insurance policy terms. Like everything else related to the complex and evolving field of cyber risk and insurance, it's complicated. Give us a call if we can be of help.

Changes to OSHA Reporting Requirements

As you've likely heard, there are some important 2015 changes to OSHA reporting requirements.

The updated recordkeeping rule includes two key changes. First, OSHA regulations require certain employers to routinely keep records of serious employee injuries and illnesses. There are two classes of employers that are partially exempt from routinely keeping records. The first is employers with ten or fewer employees at all times during the previous calendar year; they were, and remain, exempt from the recordkeeping requirement.

Also exempted are employers in certain defined low hazard industries. Examples of this would include retail, finance, insurance and real estate and certain service industry employers under some circumstances. As of 2015 the rule updates the list of industries that are exempt from the recordkeeping requirement due to relatively low occupational injury and illness rates. The old list of exempted industries was based on the old Standard Industrial Classification (SIC) system and injury and illness data from the Bureau of Labor Statistics (BLS) from 1996-1998. The new list of exempt industries is based on the North American Industry Classification System (NAICS) and injury and illness data from the BLS from 2007-2009. These are changes from prior rules, so if you were previously exempt from the recordkeeping requirement you need to check again to see if that's still the case.

Another important change that applies to all employers, with no exceptions, is that the updated recordkeeping rule expands the list of severe injuries and illnesses that employers must report to OSHA. As of January 1, 2015, all employers must report all work-related fatalities within 8 hours (as before) but now all work-related inpatient hospitalization's, amputations or loss of an eye must also be reported within 24 hours. This is a new requirement.

Should one of your employees suffer a work related injury as described above you must report it to OSHA, either by calling their toll free number at 1-800-321-OSHA(6742), calling your closest OSHA Area Office during normal business hours or using the new online form that you can find on their website. The post office is not an option to meet this requirement.

Bear in mind that these new rules are effective January 1, 2015 for employers located in states that are under Federal OSHA jurisdiction. Those located in states that have their own safety and health programs and regulations should check with their state plan for effective dates.

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