Sink or Swim

Making agency mergers & acquisitions work

By Matthew Davis

Ever hear the adage, "The two happiest days in a person's life are the day they buy their boat and the day they sell it"?

Boat ownership causes a number of unforeseen headaches for the once enthusiastic captain—and the same is true of the insurance professional who views acquiring another agency through rose-colored glasses.

There's just one important difference: Both buyer and seller should be wary of the errors & omissions exposures of mergers & acquisitions.

The Seller Side

A boat owner's liability is typically asses-sed on an occurrence basis: Any accidents that happened pre-sale are covered by the seller's expiring boat policy. Once the sale is signed, sealed and recorded, any future accidents become the problem of the new owner and his carrier.

Not so tidy with claims made E&O coverage. Often, an error that occurred prior to an agency sale is the subject of a claim that comes after. Who is responsible for that claim?

If the selling agency sells only some of its accounts and remains in business, it probably still has an E&O policy in force. Absent an unforeseen issue, that will cover the late-developing claim.

But what if the agency effectively ceases to exist once the sale concludes? If the agency merges into the buying agency with all its assets and liabilities, those claims will be the responsibility of the buying agency and its E&O carrier. Or, the buying agency can simply take over the selling agency's E&O policy, with the carrier's prior consent.

Neither of these options is ideal for the selling agency—if the buying agency decides to cancel the policy before the statute of limitations has run, the selling agency will be exposed.

The third and best option from an E&O standpoint is to purchase an extended reporting period, also known as a "tail," which can cover acts that occurred prior to the date of the agency acquisition.

The Buyer Side

The extended reporting period is also the best option for the buying agency, because it ensures that any of the selling agency's mistakes that surface post-sale will be charged to that expiring policy—not the buying agency's loss history.

Here are five more points that make good E&O sense for the buying agency:

1) Acquire assets only, not liabilities.

2) Have the selling agency purchase an extended reporting period.

3) Promptly notify your E&O carrier regarding the acquisition.

4) If the acquired business must be referenced in the E&O policy, it should only refer to "Buying Agency DBA Selling Agency," because the selling agency's name is often used for a time as its business transitions over.

5) Attach a retro date to the acquired business to make it clear that no liabilities have been acquired.

It's just as important to sell to a good agency as it is to buy from a good agency. Due diligence has its limitations, so to be on the safe side, both parties to a buy/sell agreement should ensure they have proper E&O protection.

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