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D&O Insurance: Due Diligence Questions Pertaining to M&A Transactions

Questions regarding Directors & Officers (D&O) liability in a merger or acquisition (M&A) are crucial for both the acquiring and target companies to address gaps in coverage and protect against future litigation.

D&O insurance and policy questions

Target company

- **What provisions exist in the current D&O policy?** Identify critical clauses like "Change in Control," "Bump-Up," and "Severability," which can significantly affect coverage post-merger.
- **How does the "Change in Control" clause affect coverage?** Determine when the policy will automatically terminate or trigger a run-off provision due to the sale of more than 50% of the company.
- **What run-off or "tail" coverage is needed?** Discuss the need to purchase an extended reporting period policy to cover claims made after the transaction date for wrongful acts that occurred before the deal closed.
  - **How long should the run-off coverage last?** The standard period is six years, but this should be negotiated based on specific risks.
  - **Who will pay for the run-off policy?** Determine if the target company or the buyer will be responsible for the one-time premium payment.
- **How will existing D&O policy limits and deductibles apply after the merger?** Confirm how the pre-existing policy limits will be handled and if any outstanding retentions will be affected.
- **What are the consequences of relying on the acquiring company's policy?** Understand that the buyer's D&O policy may not cover the target company's directors for pre-transaction acts, potentially leaving them exposed to liability.
- **Are there potential "straddle claims"?** Identify the risk of claims that involve wrongful acts occurring both before and after the transaction and determine how the different D&O policies will coordinate coverage.

Acquiring company

- **Will our existing D&O policy continue after the deal?** Confirm if your own "Change in Control" clause is triggered by the acquisition and if the policy will remain active without disruption.
- **What is the plan for integrating D&O coverage?** Determine how to align the policies of both companies to avoid unexpected coverage gaps.
- **What is the exposure to "legacy liabilities"?** Assess the risk of undisclosed liabilities from the target company's past that could result in a claim against the new directors.
- **Are there potential liabilities from entering a new industry?** Evaluate the risk that the acquiring company's directors, with little experience in the new industry, could incur liability in managing the acquired company.

Will the acquired company's directors remain? If so, determine how they will be covered by the new go-forward D&O policy.

Director liability and risk exposure questions

Fiduciary duties and decision-making

- **How did the board conduct due diligence?** Scrutinize the target board's process to ensure they acted with appropriate diligence and secured the best possible price for shareholders.
- **Were there any conflicts of interest?** Investigate if any directors had affiliations or financial interests in the deal that could conflict with the company's interests.
- **What information was disclosed to shareholders?** Review disclosures to ensure no material omissions or misrepresentations were made, which can lead to shareholder lawsuits.

Lawsuit and litigation history

- **What is the history of D&O claims?** Examine past D&O questionnaires and underwriting information for any legal proceedings or regulatory actions.
- **What is the status of ongoing or pending litigation?** Review any pending lawsuits against the target company and its directors to understand potential post-merger liabilities.

Indemnification and governance

- **What is the target's indemnification agreement for its directors?** Review the company's bylaws and agreements to see what protections are in place for directors and how the D&O insurance backs them.
- **How will the new board be structured?** Consider the process for determining who will be on the board of the newly combined company and how leadership will transition.

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