INSURANCE JOURNAL

It's Just a Name Change and Other 'ERPS'

Claims made insurance policies have existed for a long time. For specialty line insurance policies, such as directors and officers liability, professional liability, cyber liability etc., they are the most common type of policy issued.

They are complex, and depending on the definition of claim, as well as whether or not it's a claims made and reported form, the policies can be extremely dangerous.

What follows is the first installment of a three-part series on the complexities involved in securing extended reporting coverage in conjunction with claims made policies. I have written numerous articles on claims made trigger problems, prior act problems, prior pending claim exclusions, etc. These only make the problems more dangerous for insureds and for insurance producers. However, and unfortunately, one important aspect of the policy that I've somewhat been lax to review in depth is the complexity of the extended reporting provision (ERP) and the ability to buy optional extended reporting period coverage, also known as runoff coverage and/or retirement coverage. Even my own article, The Dangers that May Lurk in All Claims Made Policies, raises extended reporting provisions, but not in depth.

Many policies guarantee one year, but may not offer more. It does not mean that an underwriter might not be willing to quote additional years should the insured be a clean risk. However, if there have been claims it is unlikely. Equally true is the fact that the trigger for an ERP is not limited to cancellation or non-renewal. A sale of assets, stock, or an acquisition can too, yet often that provision is found in another condition in the policy.

Contributing to the problem are the implications that selling or buying a company or its assets present, and dealing with the existing insurance portfolio is typically overlooked, except as to the need to buy an extended reporting term. All too often, insurance brokers are the last to know about any such events and thus cannot advise as to what options may exist. There often is little time to implement approaches and solutions that follow.

Initial Concerns

Consider a "name change." Producers are often faced with the common problem of "it's just a name change." As a wholesale producer, we would often get requests from producers for an endorsement because it is simply a "name change." Sometimes it turned out to be true, and sometimes it didn't.

The real question is, what name change are we talking about? Often, it was more than a name change. It's one thing to be Joe Smith, and then become Joe Smith DBA "Make Money with Us." That would be a name change. However, if it was Joe Smith, and now it's "Make Money with Us Inc." or "Make Money with Us LLC" — that's not a name change. It's a new entity and therefore an organizational change. To simply get an endorsement with a name change would mean you cover an entity that does not exist, while not covering the entity that does.

The key to determining whether it is the name change, is whether the FEIN number has changed. For instance, a sole proprietor could use their Social Security number for all business issues, or could apply for and obtain an FEIN number to distinguish between personal and business pursuits.

However, if one incorporates, or forms an LLC, or any other organizational entity, they must get an FEIN number to do so. How to insure the entity becomes a quandary because it is a new one, even though it may conduct the same operations as before. Sometimes the policy will remain in the name of the proprietorship, and an endorsement will be added to pick up the new entity so all prior act dates of the proprietorship are protected, as well as go-forward coverage for the entity that could not have committed a wrongful act before inception. That way, all prior acts are preserved as the policy continues in the name of the proprietorship, even though all business is now being conducted by the additional named insured entity.

Another danger, however, is equally ever present and involves "extended reporting periods." Some policies provide neither a pre-set extended reporting time nor what the premium might be. Such provisions simply state that an underwriter will consider how many years may be granted together with the premium based on "underwriting and pricing guidelines in effect at that point in time."

That could place an insured in a dangerous position should they have serious problems with the business, in which case an underwriter may not be inclined to give more than one year and not at the usual "clean account" pricing. I've seen situations where the pricing was 800% of the expiring premium!

This is something to be avoided, as many policies come with language that automatically grants one year and others up to three years at a specific price. However, this is not always true. In addition, an underwriter may also have the option to quote more than what is stated in the policy, especially if the risk is low and has had a good "track record" as to profitability and claims history. The obvious point being the fact an underwriter can always endorse a policy beyond what the form provides as to any provision, let alone the extended reporting provision(s).

Common Events That Trigger the ERP

The most common trigger of an extended reporting provision, a.k.a. runoff provision or "tail" provision, is a cancellation or nonrenewal of the policy.

Usually that provision is bilateral, yet some policies still may limit the cancellation or nonrenewal as to when the insurance company cancels or non-renews. Such a cancellation or nonrenewal often arises due to claims experience, or a significant change in the members of the board and/or corporate officers. These changes signal something is wrong with the company, either its direction, profitability or other difficulties that could significantly and adversely change the risk and hazards. Thus, the insurer could decide to non-renew the coverage. The insured might also consider going "public" or the reverse, considering going "private," both of which could adversely change the probability of future claims taking place.

The foregoing follows a concept I've espoused for years. A claims made policy insures only one risk, which is the probability of a claim being first made during the policy term. The hazard(s) insured are a different matter and may or may not inherently affect the "risk."

Another provision is commonly called a change of control provision. This is where either the insured acquires another entity, or the insured has either sold many of its assets (usually over 50%), or over 50% of the stock of the company is sold to a new buyer. This also triggers the ERP. Typically, the policy, as of the transaction, automatically goes into "runoff mode" until the normal anniversary/expiration date of the policy. For instance, if the policy has been in force only six months, and then there is a change in control by the sale of assets, of the sale of the stock of the company, the policy mutely goes into "runoff," but the policy does not expire for another six months.

Thus, only those claims first made during the remaining six months of the policy term will be covered if the wrongful acts as alleged took place before the date of the "triggering" transaction. In addition, when the policy expires on its anniversary date, the insured may still purchase an

ERP based on what the policy states is available. Often, this may be limited to one year, but many policies offer one-, three-, five-year options with pre-set pricing for each option, etc. Usually, the premium itself is also so stated. Yet there is always that dangerous provision where the insurance company will determine what terms they will offer based on their underwriting guidelines as they exist at that point.

There are additional complexities, as well, because an ERP traditionally has been triggered by either cancellation or nonrenewal or a change in control of assets, operations, or sale of the stock of the company.

There are inherent dangers when a company is acquired, not only for the selling company but for the acquiring company, as well. It is not uncommon for the buyer to require the seller to purchase several years of ERP coverage. This is because the buyer, when either acquiring the assets or the stock transaction, wants no exposure to any known or unknown liabilities created by activities that occurred before the acquisition. The buyer will only want to be protected on a go-forward basis, whether the acquisition is asset-based or stock-based. There is an inherent problem with this traditional thinking, but more on that follows in subsequent articles on this subject.

Note: The above is the first article in a three-part series on problems that may arise with claims made policies involving extended reporting provision (ERP) coverages.

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Complexities That Arise with ERPs: Part 2

For specialty line insurance policies such as directors and officers liability, professional liability, cyber liability etc., claims made insurance policies are the most common type of policy issued.

They are complex, and depending on the definition of claim, as well as whether or not it's a claims made and reported form, the policies can be extremely dangerous.

What follows is the second installment of a three-part series on the complexities inherent in claims made policies with extended reporting provisions (ERPS). The previous article, It's Just a Name Change and Other 'ERPS,' published in the May 22, 2023, edition of Insurance Journal, addressed various problems that may arise when the need for an ERP is triggered because a client decides to simply change the name of their business — or intends an organizational change to the business — and the differences between the two.

Additional and Subtle Complexities

This article takes up where the previous one left off — with a discussion of the additional and subtle complexities involved when an ERP is triggered.

Traditionally, an ERP has been triggered by either cancellation or nonrenewal, or a change in control of assets, operations, or sale of the stock of the company.

There are inherent dangers when a company is acquired, not only for the selling company but for the acquiring company, as well. It is not uncommon for the buyer to require the seller to purchase several years of ERP coverage. This is because the buyer, when either acquiring the assets or the stock transaction, wants no exposure to any known or unknown liabilities created by activities that occurred before the acquisition. The buyer will only want to be protected on a go-forward basis, whether the acquisition is asset-based or stock-based.

There is an inherent problem with this traditional thinking, but more on that follows below.

Still, it is quite a common provision. We've all seen companies get acquired, with the seller invoking whatever extended reporting coverage they can acquire, sometimes at a significant price. That makes the buyer happy to know that there is security for any litigation that may take place arising out of a wrongful act that took place before the transaction. But that is not the only problem, and this is where the approach and analysis become important.

Asking the right questions is necessary to provide the appropriate financial protection to those involved, with the avoidance of any error and omission (E&O) claim that might be made against the broker, despite whether they are simply following an "order take" standard or not.

Is Time or Cost of an ERP Important?

All too often insurance brokers are the last to know of an impending transaction. If, by some miracle, the broker is involved early on, significant coordination can take place.

One of the first things a broker should ask is what's important to the seller — is it the length of time of the extended reporting provision, or the cost of the ERP? For instance, it may be possible to alert the existing underwriter that a transaction may take place. One might ask the underwriter that instead of the policy automatically going into ERP, which would expire at the usual anniversary date, would the underwriter allow the policy to be canceled at 11:59 PM on the day before and allow any unearned premium to be applied to the cost of the extended reporting provision with no cancellation penalty? The ERP would equally have to be ordered to allow for the intended continuity. Thus, the cost of the ERP can be reduced. That assumes that cost is a driving factor.

If, however, the policyholder wants to maximize the amount of time of the ERP, they can allow the policy to automatically go into runoff mode until the anniversary date and then buy an ERP, at the appropriate time, whatever length of time is offered and can be afforded. Depending on when the transaction closes, of course, could add significant time to the policy in that scenario.

The Subtleties Continue

Where this can become complex is when a name change and/or operation change and/or ownership change arises with the sale of assets or stock. When dealing with claims made policies, a substantial sale of assets, or an acquisition or sale of the company stock constitutes a change in control and/or a change in operations. This immediately, by most policy conditions, automatically triggers the policy into runoff mode until the policy would normally expire but only for claims first made during the policy terms but only for wrongful acts committed before the transaction date.

The existing policies of the buyer would normally cover any wrongful acts that take place after the transaction. Sometimes, though, a new "go-forward" policy (with prior acts of inception) might be necessary. Hence, initial questions can identify the need and the appropriate solution.

One more item is generally true. It is usually not an "either/or" proposition — one may need both, an ERP and a "go-forward" policy.

'C' Corporation Issues

Another scenario is when there is a sale of assets or sale of stock. Here again, the need for an ERP can be triggered simply by a request for name change, when there actually is more going on. Once it is determined that it is not just a name change but a new entity, many scenarios need to be explored.

Foremost, is the corporation itself a "C" Corp. or an S-Corp.? If it's a C corporation, then one must determine whether only the assets are being sold or if the stock is being sold. The answer to that will significantly determine the approach to be taken, especially since the usual scenario with a C Corp. is based on avoiding double taxation. Usually, it's a sale of assets.

Sometimes, it will be a stock sale to avoid double taxation by the buyer. If it's a stock sale, the solution is obvious. A runoff or ERP tail must be obtained for the years that might be available, with the additional query as to whether additional years might be available at an additional premium. The buyer's coverage(s) generally will pick up the go-forward exposure.

However, the transaction will likely be an asset sale with the buyer avoiding inheriting any unknown problems or liabilities. That still triggers the runoff provision but changes the approach.

Is the selling corporation going to be immediately and simultaneously dissolved with the funds immediately distributed to stakeholders and shareholders? If not, that means a corporation will continue operating if for no other reason than to distribute the assets as a "wind-down operation."

But the corporation itself may decide it wishes to enter a new business venture, i.e., a change of operations to avoid violating any noncompete clause that probably exists in the terms of sale documents.

If so, then a go-forward policy, with prior acts coverage of inception, in addition to ERP tail, will be required. Since the operations have changed dramatically, it is doubtful that an underwriter would continue the claims made coverage as it exists. That means they would still need to buy an ERP for as many years as may be available. In addition, a go-forward policy to cover any wrongful acts committed after the transaction will be necessary.

A go-forward policy would insure the "old corporation," as the FEIN number had not changed. Coverage would be provided for "new operations," either due to wind-down exposures, or the company seeking new opportunities in a new business environment. Subject to the usual underwriting guidelines, the go-forward coverage would be renewable year after year.

S-Corporation Issues

If it's an S-Corporation, a similar analysis is necessary. There, and subject to the usual tax liabilities, there is no double taxation when one sells the assets or a significant portion thereof. The same questions, however, apply.

A tail policy probably will be required and thus extended reporting coverage must be purchased for as many years may be available from the insurer, and as one is comfortable obtaining and paying for. Yet, again, what will happen with the funds received? Is the company going to be immediately dissolved if it's an asset sale only and the money flows to the stakeholders and shareholders and/or creditors? If not, is the company going to continue any operations even if it's a wind-down operation as opposed to some continuing new business? If so, then again, a similar approach needs to be taken in addition to purchasing extended reporting coverage. This would mean that a go-forward policy would still be necessary to cover any wrongful acts committed during the wind down process or if the company continues operating with the change in operations.

Non-Conforming 'Partial' Sale of Assets or Stock, and a Name Change or Not

There is still another scenario. That is where the S-Corp. sells substantial assets and thus could trigger the change in control provision, which would require the purchase of an extended reporting provision. However, there may be a change in operation or what was a minor part of the company now becomes the major operation of the company post sale. A name change might take place, too, yet the FEIN number would not change. It is still the same corporation but is now operating under a new name/DBA. That means it still is the same corporate shell presumably with the same senior managers.

Still, it is mainly a name change as the corporate shell remains the same. What if the operations of the company are not that much different from the original operations? Would an extended reporting provision be necessary and a new go-forward policy under those circumstances?

Consider a company that has two functionalities, and when selling the assets, one function of the company is sold off.

But the other operation is not competitive or competing with the operations sold. Is it necessary to buy tail and a go-forward policy?

Some underwriters might deem that the case and not be willing to do anything other than offer an extended reporting provision and a go-forward policy. Some underwriters may decide that the operations maintained by the original owners are such that they will not underwrite it, requiring the insured to purchase an extended reporting provision and seek a new go-forward policy from another insurer.

These need to be addressed and be looked at before the sale. If they are significantly similar to what the insurance company had covered, they may decide not to require an extended reporting provision and a new go-forward policy.

They may simply continue the coverage as is. This is where the complexity arises.

One thing is for certain, if a corporation simply sells assets and changes its name, it has not necessarily changed its corporate structure. If there is no change in officers and directors or only a minor change, coverage might continue. However, all this needs to be disclosed to any underwriting facility at risk and any new one for the final determination as to whether they agree that the risk has not been significantly increased as opposed to decreased. These are subtle issues. Still, the approach is clear and the response by the underwriters will determine the best approach for the policyholder.

Thus, a potential solution becomes clear. Is it possible to obtain one policy that still covers the entity as is, or will it be necessary that an extended reporting provision be purchased, as well as a go-forward policy, to cover any future wrongful acts? This will be determined case-by-case.

Note: The above is the second article in a three-part series on complexities that may arise with claims made policies involving extended reporting provision (ERP) coverages.

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Subtle Problems with Extended Reporting Coverage — and Creative Solutions

For specialty line insurance policies such as directors and officers liability, professional liability, cyber liability etc., claims made insurance policies are the most common type of policy issued. They are complex, and depending on the definition of claim, as well as whether or not it's a claims made and reported form, the policies can be extremely dangerous.

What follows is the third installment of a three-part series on the complexities inherent in claims made policies with extended reporting provisions (ERPS).

The first article, It's Just a Name Change and Other 'ERPS', published in the May 22, 2023, edition of Insurance Journal, addressed various problems that may arise when the need for an ERP is triggered because a client decides to simply change the name of their business — or the organizational change to the business — and the differences between the two. The second installment, published in IJ's June 5 magazine edition, took up where the previous one left off — with a discussion of the additional complexities involved when an ERP is triggered. This final article explores some of the subtler problems that may arise with extended reporting provisions.

Overall, many of the more common issues were explored in previous articles. That is not to say, however, that these are complete solutions. I have long been of the belief that extended reporting provisions, when invoked, are an incomplete solution for long-term protection. That is because one is taking a limit of liability and stretching it across at least one year and sometimes six years or more. The limits, thus, are never refreshed. So, if there are any claims during the extended reporting term, policy limits are being eroded. This could mean that policy limits could be extinguished by claim frequency, and the benefit of runoff would be lost when that happens before the term had even run out.

Eventually the ERP will expire. This means there is now a gap in coverage. Depending on the length of the original ERP, there still may be the potential for claims being made against the entity and/or its directors, officers, and/or senior managers for wrongful acts that took place long before the actual transaction triggering these coverage events.

For instance, for a construction company, the statute of limitations for construction defects is 10 years. Thus, should a three-year extended reporting provision expire, there could be several years where the directors and officers of the corporation are exposed to construction defect claims. In this case, the reporting provision is an incomplete solution. This may also expose the buyer to those claims depending on the sale, i.e., if with a stock sale, it took over the company. Would any indemnification agreement between buyer and seller still be enforceable at that point? The buyer may have some exposure to the injured party before the date of transaction, but trying to get funds from the seller several years after the transaction has closed may prove to be a problem.

I am not aware of an insurer that might extend the term when it expires, even if it is claim free. I am also unaware of any new insurer routinely willing to offer an additional extended reporting provision to take over.

A Creative Solution

It is possible to think outside the box. Consider the following hypothetical.

If company "A" is an excellent risk, a well-managed company with a good loss history, would that not be acceptable to any reasonable underwriter including honoring any prior act dates, etc. The answer would obviously be "yes." What about company "B?" If company B is a good company, well-managed, good performance and has a good claim history, would that same insurer also like to write company B? Again, the answer is "yes."

So why is it when company A buys company B — B is not a good risk? The perception now is that company B is a risky company, and the insurer will only pick up company B as a subsidiary on a go-forward basis. They will not provide coverage for any wrongful acts that took place before the transaction.

It doesn't make sense, especially if they would write the company on its own standalone basis while honoring any prior act dates, etc. Why does the transaction suddenly make it a bad risk? This analysis becomes even more relevant if during the acquisition, the same staff and management is coming over, which would enhance the insurability of company A because they are getting experienced personnel and the continuity of the operation is more likely. It also shouldn't matter if it's a 100% asset sale as the selling entity will no longer exist.

This is possible and has been done. If the insurer likes company B and will write company B, there is no reason they shouldn't be willing to write the acquired company either as a subsidiary or on an asset basis and still pick up all prior acts, etc. This would require unique endorsements to make it clear that the prior act exposures are being honored for the acquired company.

In addition, there would be a necessity for one other endorsement. The insurance policy for company A would still have a transaction provision that would clarify that if they acquire a company, that company is automatically covered, sometimes for only a specified period until the insurer is advised, but only for wrongful acts that took place after the transaction. Obviously, such a provision would have to be amended so as not to apply to the transaction in issue. Still, it is possible to do it and I did so frequently as a wholesale broker.

How to Close the Gap When an ERP Expires

A similar approach might be taken when an ERP is about to expire. As all professionals know, for the insurance company to write a new piece of business insured with another insurer, one of the industry trends since the 1970s has always been to honor the existing prior act dates, and/or prior pending litigation dates. If they are unwilling to do so, it is dangerous for the insured to change insurers.

Usually, the only reason a prior act date might not be honored is due to a poor loss history giving rise to a non-renewal of the policy or prior act date by the existing insurer, thus requiring the insured to buy an ERP. A new go-forward policy that is retroactive date inception would also be needed by such a non-renewal, even though there probably is no transaction triggering the need.

So, how can a policy holder or even a buyer be protected when the extended reporting term ends? What if there isn't any "loss problem?" The basis for this is twofold, since traditionally no insured will move carriers unless all those prior act dates are honored. Those insurers wanted to make sure that there has always been coverage for prior acts for them to honor that date going forward.

Such is the case with an ERP about to expire as it operates similarly to a prior act date because it covers prior activities of the insured for a specified period, no differently than a policy would cover wrongful acts subject to the retroactive date of that policy. The insured has had the appropriate prior act coverage despite whether it's based on a prior act provision in the existing policy, or the runoff provisions of an extended reporting provision.

Prior errors were covered. Should it matter that coverage was provided by an ERP rather than a prior act provision? Is it possible for an insurance company to extend a prior act date to pick up the same when the ERP expires?

The answer is yes, it has been done and becomes another creative think-outside-the-box solution.

Note: The above is the third and final installment in a series of articles addressing ERPs.

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