

## Workshop W12

*Wednesday, October 11, 1:30-3 p.m. and 3:30-5 p.m.*

# **NAVIGATING MERGER AND ACQUISITION RISKS**

Presented by



**Michael J. O'Neill, CPCU, ARM**  
**Executive Vice President**  
**American Contractors Insurance Group**

Mergers and acquisitions present unique risk management challenges for the purchasing or surviving entity. From ensuring coverage for discontinued operations and successor liability to estimating the impact on loss-sensitive insurance programs, risk managers and their insurance representatives must carefully examine all aspects of the transaction. This workshop addresses critical risk and insurance issues needing attention in the due diligence phase of the process.

- Addresses the nuances between an asset-only acquisition and an assets and liabilities acquisition.
- Demonstrates the impact of the merger or acquisition on a contractor's experience modifier, retrospective loss rating program, or self-insurance program.
- Shows how to identify and arrange appropriate protection for discontinued operation risks and successor liability.

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**Michael J. O’Neill, CPCU, ARM**  
**Executive Vice President**  
**American Contractors Insurance Group**

Mr. O’Neill is presenting Workshop W12, “Navigating Merger and Acquisition Risks,” on Wednesday afternoon. He has been involved in the construction insurance industry for more than 30 years. He is executive vice president of American Contractors Insurance Group, a construction industry-owned insurance organization in Dallas. Mr. O’Neill is a frequent speaker for construction industry trade associations; he has spoken 16 times at the Construction Risk Conference. His expertise lies in the areas of captive management, risk management, retention analysis, contractual risk transfer, development of specialized coverage, and risk funding programs. Mr. O’Neill has written many articles for construction industry publications, including AGC, CFMA, and *Engineering News Record*.

## ***Notes***

This file is set up for duplexed printing. Therefore, there are pages that are intentionally left blank. If you print this file, we suggest that you set your printer to duplex.

# NAVIGATING MERGER AND ACQUISITION RISKS

*Michael J. O'Neill, CPCU, ARM*  
*American Contractors Insurance Group*

## **I. Type of Transaction**

- A. Merger
- B. Acquisition
- C. Consolidation
- D. Asset Purchase vs. Stock Purchase

## **II. Successor Liability**

### **III. Pollution and Environmental Exposures**

- A. Owned Property
- B. Ongoing Operations
- C. Completed Operations
- D. Assignment

## **IV. Directors and Officers Liability**

- A. Coverage
- B. Limits
- C. Assignment

## **V. Risk Financing Issues**

- A. Self-Insurance
- B. Retrospective Rating Plans
- C. Deductible Plans
- D. Collateral
- E. Letters of Credit

## **VI. Workers Compensation Issues**

- A. Experience Rating Modifier
- B. Current Safety Program
- C. Historical Losses
- D. Safety Statistical Analysis

## **VII. General Liability Concerns**

- A. Current Subcontractor Documents
- B. Subcontractor Prequalification
- C. Current Loss Control Program
- D. Current Quality Control Program
- E. Analysis of Past Projects
- F. Statute of Repose Exposure
- G. Assignment

## **VIII. Auto Liability Concerns**

- A. Owned, Hired and Nonowned Vehicles
- B. Lease Obligations
- C. Assignment

## **IX. Property Issues**

- A. Real Property
- B. Personal Property
- C. Loss of Use

D. Consequential Business Interruption

E. Contractors Equipment

F. Installation Floater

G. Builders Risk

H. Limits

I. Deductibles

J. Assignment

**X. Participation in Past Joint Ventures**

A. Residual Completed Operations

B. Joint and Several Liabilities

**XI. Participation in Owner Controlled Insurance Programs**

A. Completed Operations

B. Differences in Conditions (DIC)

**XII. Fidelity**

A. Superseded Suretyship

**XIII. Surety**

A. Line of Surety Credit

B. Corporate and/or Personal Indemnity

C. Loan Covenants

**XIV. Integration of the New Entity into the Corporate Culture of the Acquirer**

A. Risk Management Boot Camp

B. Benchmarking of Safety, Claims and Risk Management Best Practices

C. Establishment of Strategic Goals and Objectives

D. Develop a List of Action Items, Assign Responsibility and Due Dates

**XV. Summary**

## Navigating Merger and Acquisition Risks



### Presented By:

**Michael J. O'Neill, CPCU, ARM**  
**Executive Vice President**  
**American Contractors**  
**Insurance Group**  
**Dallas, TX**



## Mergers and Acquisitions



- **Based upon data from FMI.**
- **Merger and acquisitions activity is running at a high level.**

## **Mergers and Acquisitions**



### **Reasons for Mergers and Acquisitions**

- **Enter new market segments.**
- **Diversification.**
- **Geographic expansion.**
- **Addition of high quality personnel.**

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## **Mergers and Acquisitions**



### **Recent Activity**

- **Ragnar Benson acquired by William Charles, Ltd.**
- **Miller-Watts acquired by The Weitz Company, LLC.**
- **CC Woods acquired by LeChase Construction Services, LLC.**

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## Mergers and Acquisitions



### Recent Activity

- **Global Power Equipment Group acquired by Williams Industrial Services.**
- **The Austin Company acquired by Kajima USA.**
- **Cherry Hill Construction, Inc., acquired by Perini Corporation.**
- **Rudolph and Sletten, Inc., acquired by Perini Corporation.**

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## Mergers and Acquisitions



### Type of Transaction

- **Asset sale – Purchase of assets only, including existing contracts.**
- **The liabilities of the seller do not pass to the buyer.**

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## **Mergers and Acquisitions**



### **Exceptions to the Rule**

- **Buyer expressly agrees to assume the seller's liabilities/obligations.**
- **Transaction amounts to a DeFacto Merger.**
- **Transaction is a fraudulent attempt to escape liability.**

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## **Mergers and Acquisitions**



### **DeFacto Merger**

- **Social Justice Theory – Benefits from the sellers “goodwill,” buyer should assume responsibility for development of the “goodwill.”**
- **Cheapest Cost Available – Buyer is better able to buy insurance for such claims than the tort victim.**

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## Mergers and Acquisitions



### Protection Against DeFacto Merger

- **Buyer drafts and executes an indemnity provision that excludes the liability of the seller.**

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## Mergers and Acquisitions



### Types of Mergers

- **Mergers – Most are carried out as some form of “stock deal.”**
- **Statutory Mergers – The seller merges with and disappears into the buyer.**
- **Stock-Swap – Swapping the sellers shares for shares in the buyer.**
- **Stock for Assets – Buyer uses its stock to buy the sellers assets.**

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## **Mergers and Acquisitions**



### **Successor Liability**

- **Successor companies look for ways to claim coverage under current and past insurance policies.**

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## **Mergers and Acquisitions**



### **Successor Liability**

- **Buyer may have protection under the seller's policies that were in force at the time of the injury or damage.**
- **Buyer would not be a named insured under the seller's past policies.**
- **Under ISO forms, no automatic coverage for the successor company.**

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## Mergers and Acquisitions



### Successor Liability

- **Successor may have some coverage under its past CGL policy.**
- **Loss would be covered by a policy that was in force at the time the injury or damage occurred.**

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## Mergers and Acquisitions



### Pollution and Environmental Exposures

- **Due diligence process should closely examine these exposures.**
- **Long-tail liabilities.**

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## **Mergers and Acquisitions**



### **Pollution and Environmental Exposures**

- **Owned Property**
  - **Current**
  - **Past**
- **U.S.T.s**
- **Fuels, Oils**
- **Solvents**

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## **Mergers and Acquisitions**



### **Pollution and Environmental Exposures**

- **Ongoing Operations**
- **Remediation Work**
- **Non-Remediation Work**
- **Subcontracted Work**

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## **Mergers and Acquisitions**



### **Pollution and Environmental Exposures**

- **Completed Operations**
- **Statute of Limitations**
- **Statute of Repose**

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## **Mergers and Acquisitions**



### **Pollution and Environmental Exposures**

#### **Claims Made or Occurrence Policy**

- **Retroactive Date**
- **Extended Reporting Period**

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## **Mergers and Acquisitions**



### **Pollution and Environmental Exposures**

#### **Assignment of Policy**

- **Research this Policy Provision**
- **Determine if Policy is Assignable**
- **Does it Require Consent of Insurer?**

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## **Mergers and Acquisitions**



### **Contractors Pollution Liability**

#### **Newly Acquired Entities**

**A few forms also provide automatic coverage with respect to organizations the named insured acquires or forms during the policy period. (Joint ventures or partnerships of the named insured may not qualify for this coverage.) Coverage usually expires 90 days after acquisition or formation if the organization has not been added to the declarations page as a named insured by that date. This temporary coverage is designed merely to prevent coverage gaps arising out of oversights in obtaining insurance. If the policy renews during that 90-day period, no coverage will apply under the renewal policy unless the organization is added as a named insured.**

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## Mergers and Acquisitions



### Directors and Officers Liability

- **Review both the buyer and seller D&O policies.**
- **Adequate limits.**
- **Any merger and acquisition exclusions or limitations.**
- **Claims-made D&O policy – watch the retroactive date.**
- **Is the policy assignable?**

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## Mergers and Acquisitions



### Risk Financing Issues

- **Asset only sale – Liabilities stay with the seller.**
- **Stock purchase – Assets and liabilities move to the buyer.**

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## Mergers and Acquisitions



### Self-Insured Retentions

- **Determine the retentions by line of business and by policy year.**

	<u>W/C</u>	<u>G/L</u>	<u>A/L</u>
2001	250K	100K	50K
2002	250K	100K	50K
2003	250K	100K	50K
2004	250K	100K	50K

- **Any aggregate stop loss feature.**
- **Need for an actuarial review.**

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## Mergers and Acquisitions



### Retrospective Rating Plans

#### **Determine:**

- **Open retro periods.**
- **Loss limitation by line, by year.**
- **Treatment of ALAE.**
- **Calculate worst-case maximum premium exposure.**
- **Any buy-out option for the tail.**

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## Mergers and Acquisitions



### Large Deductible Plans

- **Determine open deductible plan periods.**
- **Deductible amount, by line, by year.**
- **Treatment of ALAE.**
- **Aggregate stop loss.**

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## Mergers and Acquisitions



### Collateral

- **Many risk financing programs require collateral, L.O.C. or surety bond to securitize the unfunded portion of the premiums.**
- **Determine outstanding collateral amounts.**
- **Calculate the future collateral obligations.**

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## Mergers and Acquisitions



### Workers Compensation Issues

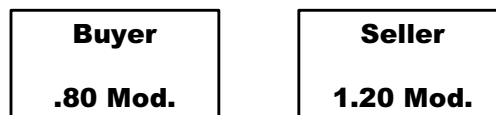
- **Experience modifier.**
- **Become familiar with the change in status and combination of entities rule.**
- **Unless there is a material change in the operations the experience of the combined entities will be used.**

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## Mergers and Acquisitions



### Example:



- **Combined experience.**
- **Will increase the buyers mod.**
- **Watch out for pre-qualification issues.**

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## Mergers and Acquisitions



### Due Diligence Items

- **Analyze the current safety program.**
- **Benchmark the data against the buyers data.**
- **Detailed review of all W/C cases.**
- **Calculate frequency and severity metrics and benchmark.**

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## Mergers and Acquisitions



### Due Diligence Items

- **Review status of operations.**
- **Review W/C class codes.**
- **Become familiar with W/C laws in the seller's states of operations.**

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## **Mergers and Acquisitions**



### **Workers Compensation – NCCI Policy Language**

- **Who Is Insured**
- **You are insured if you are an employer named in Item 1 of the Information Page. If that employer is a partnership, and if you are one of its partners, you are insured, but only in your capacity as an employer of the partnership's employees.**

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## **Mergers and Acquisitions**



### **General Liability Concerns**

- **Review the current subcontract documents.**
- **Gauge effectiveness of the risk transfer.**
- **Self-performed trades vs. subcontractor trades.**
- **Subcontractor pre-qualification program.**
- **Subcontract audit.**

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## Mergers and Acquisitions



### General Liability Concerns

- **Review the current G/L loss control program.**
- **Emphasis on “ongoing” as well as “completed operations.”**
- **Is there a written quality control program?**
- **If so, is it adequate in light of the risk due to long-tail construction defect claims?**

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## Mergers and Acquisitions



### General Liability Concerns

- **Analyze past projects.**
  - **Type**
  - **By state**
- **Review the state-specific statute of repose.**
- **Right to repair statutes, if any.**

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## **Mergers and Acquisitions**



### **General Liability Concerns**

- **Analyze the G/L loss data.**
- **Calculate frequency and severity rates and benchmark with buyer.**
- **Review tender of defense success ratio.**
- **Request an up-to-date G/L litigation report, including status, strategy and settlement values.**

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## **Mergers and Acquisitions**



### **General Liability Concerns**

#### **Assignment**

- **Is the policy assignable?**
- **Is the consent of the insurer required?**

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## Mergers and Acquisitions



### **Commercial General Liability – ISO Policy Language**

**3. Any organization you newly acquire or form, other than a partnership, joint venture or limited liability company, and over which you maintain ownership or majority interest, will qualify as a Named Insured if there is no other similar insurance available to that organization. However:**

- **a. Coverage under this provision is afforded only until the 90th day after you acquire or form the organization or the end of the policy period, whichever is earlier;**
- **b. Coverage A does not apply to "bodily injury" or "property damage" that occurred before you acquired or formed the organization; and**
- **c. Coverage B does not apply to "personal and advertising injury" arising out of an offense committed before you acquired or formed the organization.**

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## Mergers and Acquisitions



### **Umbrella Liability – Zurich form U-UMB-103-B CW (07/2003)**

**Insured means:**

- **You: and**
- **Any person or organization included as an insured in the underlying insurance.**
- **Note: No automatic coverage follows the form of the underlying insurance.**

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## **Mergers and Acquisitions**



### **Auto Liability Concerns**

- **Complete list of all owned and leased vehicles.**
- **Analyze the hired and non-owned exposure – Is it properly insured?**
- **Insurance obligations for leased vehicles.**

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## **Mergers and Acquisitions**



### **Auto Liability Concerns**

- **Analyze the current auto fleet safety program.**
- **Calculate the frequency and severity rates and benchmark with buyer.**
- **Review driver policy.**
- **Watch for after-hours and family use exposures.**
- **Request an up-to-date auto liability litigation report, including status, strategy and settlement values.**

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## Mergers and Acquisitions



### Auto Liability Concerns

- **Is the policy assignable?**
- **Does it require consent of the insurer?**

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## Mergers and Acquisitions



### Who Is An Insured

The following are "insureds":

- **You for any covered "auto".**
- **Anyone else while using with your permission a covered "auto" you own, hire or borrow except:**
  - **(1) The owner or anyone else from whom you hire or borrow a covered "auto". This exception does not apply if the covered "auto" is a "trailer" connected to a covered "auto" you own.**
  - **(2) Your "employee" if the covered "auto" is owned by that "employee" or a member of his or her household.**

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## Mergers and Acquisitions



- **(3) Someone using a covered "auto" while he or she is working in a business of selling, servicing, repairing, parking or storing "autos" unless that business is yours.**
- **(4) Anyone other than your "employees", partners (if you are a partnership), members (if you are a limited liability company), or a lessee or borrower or any of their "employees", while moving property to or from a covered "auto".**
- **(5) A partner (if you are a partnership), or a member (if you are a limited liability company) for a covered "auto" owned by him or her or a member of his or her household.**
- **Anyone liable for the conduct of an "insured" described above but only to the extent of that liability.**

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## Mergers and Acquisitions



### Property Issues

- **Real property**
- **Mortgagee**

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## Mergers and Acquisitions



### Property Issues

- **Valuation**
- **All-risk vs. Named perils**
- **Deductibles**

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## Mergers and Acquisitions



### Property Issues

#### **Loss of Use/Business Interruption**

- **Amount Insured**
- **Waiting Period**
- **Contingent Exposure**

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## **Mergers and Acquisitions**



### **Property Issues**

#### **Contractor Equipment**

- **Schedule**
- **Values**
- **All-risk vs. Named peril**
- **Special risks, e.g. waterborne**
- **Deductibles**

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## **Mergers and Acquisitions**



### **Property Issues**

#### **Builder Risk**

- **In-force policies, blanket or specific**
- **Full coverage or D.I.C.**
- **Valuation**
- **All risk vs. Named perils**
- **Sub-limits – quake, coastal windstorm and flood**
- **Deductibles**

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## Mergers and Acquisitions



### Commercial Property – Industrial Risk Insurers

- The IRI form provides 120 days of automatic coverage for newly constructed, acquired, or leased real or personal property. (Note that property under construction is specifically included.) This coverage is subject to three sublimits: one that applies to "class 1" locations, another that applies to "class 2" locations, and a third that applies to extra expense loss in connection with any newly acquired location. The dollar amounts of the "class 1" and "class 2" sublimits are shown in the declarations. The \$100,000 extra expense sublimit does not appear in the declarations but is instead established in the text of the provision itself.

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## Mergers and Acquisitions



### Commercial Property – Industrial Risk Insurers

- Class 1 locations are defined in the form as those that are of less than 10 percent frame construction, are located in a protection class 8 or better, and have an automatic fire suppression system designed and installed in accordance with National Fire Protection Association (NFPA) codes. Class 2 locations are any locations not meeting class 1 criteria. Typically the class 1 newly acquired sublimit will be significantly higher than the one applicable to class 2 locations.
- The class 1 and class 2 newly acquired property sublimits apply to both direct damage and time element loss. However, IRI's newly acquired property provision specifies that no time element coverage is provided in connection with loss to property under construction. Furthermore, extra expense coverage applies to newly acquired property only if it applies to scheduled locations, subject to the \$100,000 sublimit.

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## **Mergers and Acquisitions**



### **Broad Form Named Insured Endorsements**

**Many contractors have a large number of subsidiaries. Forgetting to name even one of these companies as an insured could lead to large uninsured losses. A broad form named insured endorsement provides automatic coverage for all subsidiary, affiliated, associated, controlled, or allied companies, corporations, or firms for which the contractor has responsibility for placing insurance.**

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## **Mergers and Acquisitions**



### **No Notice Requirement**

- **The Named Insured as shown in the Declarations and if such organization is a corporation also includes:**
  - **Any subsidiary company of such organization, including any subsidiary company thereof:**
  - **Existing at the effective date of this policy; or**
  - **Acquired during the "policy period."**

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## Mergers and Acquisitions



- **Any other company controlled and actively managed by such organization or any such subsidiary, other than a partnership or joint venture:**
  - **At the effective date of this policy; or**
  - **If the control and active management thereof was acquired during the "policy period."**

### **Notice Requirement**

- **All subsidiary, associated, affiliated companies or owned and controlled companies as now or hereinafter constituted and of which prompt notice has been given to the Company.**

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## Mergers and Acquisitions



### **BROAD FORM NAMED INSURED ENDORSEMENT**

**It is agreed that:**

**Throughout this policy, the words "you" and "your" refer to the Named Insured shown in the Declarations and any business entity incorporated or organized under the laws of the United States of America (including any State thereof), its territories or possessions, or Canada (including any Province thereof) which the Named Insured shown in the Declarations owns, during the policy period, an interest in such entity of more than fifty percent (50%). If other valid and collectible insurance is available to any business entity covered by this policy solely by reason of an ownership by the Named Insured shown in the Declarations in excess of fifty percent (50%), this insurance is excess over the other insurance, whether primary, excess, contingent, or on any other basis.**

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## **Mergers and Acquisitions**



### **Participation in Joint Ventures**

- **Current J/Vs**
- **Review of J/V agreement**
- **How insured**
- **Tail exposure**
- **Loss sensitive vs. Guaranteed cost**
- **Deductibles**

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## **Mergers and Acquisitions**



### **Participation in Joint Ventures**

- **Past joint ventures.**
- **Statute of repose applicable.**
- **Completed operation coverage.**
- **Are the partners still financially solvent?**
- **Joint and several liability.**
- **Residual J/V completed operations exposure.**

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## Mergers and Acquisitions



### Participation in OCIPs and CCIPs

- **These programs have become common on large and complex projects.**
- **Current projects**
  - **Insurers**
  - **Limits**
  - **Coverage**
  - **Tail Coverage**
  - **DIC in Place**

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## Mergers and Acquisitions



### Participation in OCIPs and CCIPs

#### **Past Projects**

- **Insurers – Watch for Reliance, Kemper and other insolvent insurers.**
- **Limits.**
- **Coverage.**
- **Key issue is tail to the statute of repose.**
- **DIC coverage.**

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## **Mergers and Acquisitions**



### **Fidelity Coverage**

- **Is coverage in place?**
- **Limit.**
- **Form.**
- **Deductible.**
- **Superseded suretyship issue.**

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## **Mergers and Acquisitions**



### **Surety**

- **How are current in force bid bonds affected?**
- **How are in force performance and payment bond affected?**
- **Impact on the line of surety credit.**
- **New/updated corporate/personal indemnity.**

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## Mergers and Acquisitions



### Report to Management

- **As part of the overall due diligence process, a risk management report needs to be developed and presented to senior management.**
- **Special emphasis on historical exposures, losses, frequency and severity rates.**
- **Impact on the current cost of risk.**
- **Recommendation for an actuarial review may be warranted.**

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## Mergers and Acquisitions



### Integration of the Acquired Entity into the Corporate Culture of the Buyer

- **Recommend a one-day risk management bootcamp.**
- **Strategic planning session.**
- **Establish strategic goals and objectives.**

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## **Mergers and Acquisitions**



### **Integration of the Acquired Entity into the Corporate Culture of the Buyer**

- **Benchmarking of key measurement criteria.**
  - **LTA per 200,000 man-hours**
  - **G/L and A/L frequency rates**
  - **Severity index by line**

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## **Mergers and Acquisitions**



### **Integration of the Acquired Entity into the Corporate Culture of the Buyer**

- **Analysis of past losses.**
  - **Trends**
  - **Hot spots**
  - **Improvements**
  - **Lessons learned**

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## Mergers and Acquisitions



### Identification of Validated Best Practices

- **Risk management.**
- **Loss control.**
- **Fleet safety.**
- **Claims management.**

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## Mergers and Acquisitions



### Develop a List of Action Items

- **Identify the sponsor.**
- **Assign responsible party.**
- **Set due dates.**

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## Mergers and Acquisitions



- **Create meeting minutes with action items.**
- **Distribute to all attendees.**
- **Two-week status reports.**
- **Six-month “Gut Check.”**

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## Mergers and Acquisitions



### Summary

**The high risk and relative low rewards of the construction market require a well-defined risk management review prior to any mergers and acquisitions.**

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