

## Workshop T4

**Tuesday, October 28, 1:30–3:00 p.m. and 3:30–5.00 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 to be addressed 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.

# Cozen O'Connor— Our Construction Industry Practice

Cozen O'Connor serves our construction industry clients with the active commitment of seasoned lawyers who provide personalized attention and the resources of a law firm with offices nationwide. Our extensive knowledge of the industry and depth of experience in handling construction-related matters ranges from the negotiation of contracts to the representation of clients in construction-related accidents and defects litigation.

We counsel many segments of the construction industry and actively represent our clients in disputes in both federal and state courts before regulators, arbitrators and mediators. Issues include claims for monies due, building defects and delays, OSHA and EEOC citations, ADA and other civil rights violations, zoning, labor and employment concerns, as well as surety matters. Our lawyers have been involved with all phases of the construction process and virtually every type of structure.

When it comes to construction law and litigation, we get the job done.



**COZEN**  

---

**O'CONNOR**<sup>®</sup>

John J. McDonough · F. Warren Jacoby  
jmcdonough@cozen.com · fjacoby@cozen.com · www.cozen.com

500 Attorneys: Atlanta · Charlotte · Cherry Hill · Chicago · Dallas · Denver · Houston  
London · Los Angeles · Miami · Newark · New York · Philadelphia · San Diego · San Francisco  
Santa Fe · Seattle · Toronto · Trenton · Washington, DC · West Conshohocken · Wilmington

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

Mr. O'Neill is presenting Workshop T4, "Navigating Merger and Acquisition Risks," on Tuesday 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 19 times at the IRMI Construction Risk Conference, and is a recipient of the IRMI Words of Wisdom speakers' award. 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**

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

3

## Mergers and Acquisitions



### **Recent Activity**

- URS acquired Washington Group
- Granite acquired A.J. Diani Construction Co.
- Brown & Root acquired BE&K
- Perini acquired Tutor-Saliba
- Hochtief acquired Turner Construction Company
- Hochtief acquired Flatiron Structures

4

## Mergers and Acquisitions



### **Recent Activity**

- Jacobs acquired Carter & Burgess
- Jacobs acquired W.H. Linden Co.
- Jacobs acquired Edwards and Kelsey

5

## Mergers and Acquisitions



### **Recent Activity**

- 6/26/06 Lindsey, Goldberg & Bessemer acquired Brock Group.
- Brock Group has acquired the following:
  - XServ Inc.
  - A&L Industrial Construction
  - Steeplejack Industrial Group
  - Page Industries
  - Westcor Services Limited
  - Miken Specialties Limited
  - Atlantic Industrial, Inc.

6

## 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

7

## Mergers and Acquisitions



### Exceptions to the Rule

- Buyer expressly agrees to assume the seller's liabilities/obligations
- Transaction amounts to a de facto merger
- Transaction is a fraudulent attempt to escape liability

8

## Mergers and Acquisitions



### **Protection Against De Facto Merger**

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

9

## 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

10

## Mergers and Acquisitions



### **Pollution and Environmental Exposures**

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

11

## Mergers and Acquisitions



### **Pollution and Environmental Exposures**

- Owned property
  - Current
  - Past
- U.S.T.s
- Fuels, oils
- Solvents

12

## Mergers and Acquisitions



### **Pollution and Environmental Exposures**

- Ongoing operations
- Remediation work
- Non-remediation work
- Subcontracted work

13

## Mergers and Acquisitions



### **Pollution and Environmental Exposures**

- Completed operations
- Statute of limitations
- Statute of repose

14

## Mergers and Acquisitions



### **Pollution and Environmental Exposures**

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

- Retroactive date
- Extended reporting period

15

## 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?

16

## 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.

17

## 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?

18

## Mergers and Acquisitions



### Risk Financing Issues

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

19

## 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> |
|------|------------|------------|------------|
| 2004 | 250K       | 100K       | 50K        |
| 2005 | 250K       | 100K       | 50K        |
| 2006 | 250K       | 100K       | 50K        |
| 2007 | 250K       | 100K       | 50K        |

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

20

## 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 buyout option for the tail

21

## Mergers and Acquisitions



### **Large Deductible Plans**

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

22

## 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

23

## 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

24

## Mergers and Acquisitions



### Example:

Buyer  
.80 Mod.

Seller  
1.20 Mod.

- Combined experience
- Will increase the buyers mod
- Watch out for prequalification issues

25

## 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

26

## 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

27

## Mergers and Acquisitions



### **General Liability Concerns**

- Review the current subcontract documents
- Gauge effectiveness of the risk transfer
- Self-performed trades vs. subcontractor trades
- Subcontractor prequalification program
- Subcontract audit
- Statutes of limitation
- Statutes of repose

28

## 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?
- Retention and documentation issues

29

## 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

30

## Mergers and Acquisitions



### **General Liability Concerns**

- Analyze the G/L loss data
- Calculate the IBNR, funded or unfunded
- 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

31

## Mergers and Acquisitions



### **General Liability Concerns**

#### **Assignment**

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

32

## 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—umbrella follows the form of the underlying insurance.

33

## Mergers and Acquisitions



### **Auto Liability Concerns**

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

34

## 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

35

## Mergers and Acquisitions



### Auto Liability Concerns

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

36

## Mergers and Acquisitions



### Property Issues

- Real property
- Mortgagee

37

## Mergers and Acquisitions



### Property Issues

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

38

## Mergers and Acquisitions



### Property Issues

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

- Amount insured
- Waiting period
- Contingent exposure (supply chain)

39

## Mergers and Acquisitions



### Property Issues

#### **Contractor Equipment**

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

40

## 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

41

## 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.

42

## 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.

43

## 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.

44

## 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."

45

## 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.

46

## 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.

47

## 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
- Collateral

48

## Mergers and Acquisitions



### Participation in Joint Ventures

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

49

## 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

50

## Mergers and Acquisitions



### **Participation in OCIPs and CCIPs**

#### **Past Projects**

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

51

## Mergers and Acquisitions



### **Fidelity Coverage**

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

52

## 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

53

## 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

54

## 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.