# Risk and insurance issues in M&As

Mergers and acquisitions offer firms and their employees great opportunity for reward. At the same time, risk lurks at every corner. Here's how to address it.

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GUEST SPEAKER

With merger and acquisition activity expected to rise, design firm buyers or sellers need to consider the related risk and insurance issues. This should encompass a broad-based evaluation that goes far beyond insurance. In other words, parties should really be thinking about risk from an "enterprise risk management" (ERM) perspective. ERM examines risk impacts in several key areas:

- **Strategy** – How does the combination fit each firm's strategic goals? Are there synergies? New capabilities or geographic territories?
- **Operations** – Does the acquirer have the management talent/time to ensure timely integration? Are there management systems to ensure proper oversight? How will client relationships be affected?
- **Financial** – How will the combination affect profitability, capital structure, and expenses? Are there economies of scale? Are accounting systems compatible?
- **Human capital** – Will the right people stay and be motivated by the combination? What will it take to align compensation, incentive, benefit, and other plans and processes?
- **Compliance/security** – Are there legal hurdles? How will information systems mesh while ensuring security and availability of needed data?
- **Reputational** – How will this combination be viewed by stakeholders? Can the firms manage the transition period and avoid distractions?

Taking time to evaluate these issues on the front-end and then develop plans to address each area can help ensure a successful transaction and ongoing success.

**Addressing certain risks with insurance.** Although ERM, by definition, goes well beyond insurance, there are some risks that either can or must be addressed by insurance. For architects, engineers and other construction professionals they include exposures arising from professional services, which can be covered by professional liability insurance (PLI). These policies are written on a claims-made basis, which can complicate M&A deals.

Special care must be paid to issues related to so-called "tail coverage" and retroactive dates to ensure continuity of protection. In addition, claim and circumstance reporting requirements suggest careful attention to uncovering claims or potential claims and reporting such to insurers on a timely basis.

Beyond professional liability, there are a few other claims-made policies that should also be reviewed and appropriate action taken including:

- Directors and officers' liability (D&O);
- Employment practices liability (EPLI);
- Fiduciary liability; and
- Employee benefits liability (part of the general liability policy).

In the context of an M&A, both D&O and EPLI insurance can be important to protect the firms and their individual executives. Since any merger or acquisition involves strategic and financial decisions that are subject to interpretation, there is always the chance that one or more disgruntled shareholder will file suit against the officers and directors. D&O liability insurance provides important protection against such suits.

At the same time, there are often employment decisions that come with combining organizations, heightening the potential for an employment-practices claim covered by employment practices liability insurance.

See DAN KNISE, page 8

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# IN BRIEF

**CONGESTION NATION:** As traffic congestion continues to worsen, the time required for a given trip becomes more unpredictable, and researchers now have a way to measure that degree of unreliability, introduced for the first time as part of the annual Urban Mobility Report (UMR), published by the Texas A&M Transportation Institute (TTI).

The Planning Time Index (PTI), a measure of travel reliability, illustrates the amount of extra time needed to arrive on time for higher priority events, such as an airline departure, just-in-time shipments, medical appointments or especially important social commitments.

If the PTI for a particular trip is 3.00, a traveler would allow 60 minutes for a trip that typically takes 20 minutes when few cars are on the road. Allowing for a PTI of 3.00 would ensure on-time arrival 19 out of 20 times.

PTIs on freeways vary widely across the nation, from 1.31 (about nine extra minutes for a trip that takes 30 minutes in light traffic) in Pensacola, Fla., to 5.72 (almost three hours for that same half-hour trip) in Washington, D.C., according to the study by TTI, a member of The Texas A&M University System.

Rankings of the nation's most congested cities vary slightly from year to year, and many of this year's top 10 are repeat performers. Washington, D.C. tops the list, followed by Los Angeles, San Francisco-Oakland, New York-Newark and Boston. The second five include Houston, Atlanta, Chicago, Philadelphia and Seattle. The report provides a detailed illustration of traffic problems in a total of 498 U.S. urban areas.

In addition to PTI, the 2012 UMR also debuts an estimate of the additional carbon dioxide ($CO_2$) emissions attributed to traffic congestion: 56 billion pounds – about 380 pounds per auto commuter. The total financial cost of congestion in 2011 was $121 billion, up $1 billion from the year before and translating to $818 per U.S. commuter. Of that total, about $27 billion worth was wasted time and diesel fuel from trucks moving goods on the system.

The methods and measures developed by TTI and used in the Urban Mobility Report have been successfully implemented for policy making and prioritizing congestion-mitigating projects," says report co-author and researcher Tim Lomax.

"In light of the recent signing of the Moving Ahead for Progress in the 21st Century (MAP-21) Act, there is greater importance on using such measures to prioritize transportation improvement spending to get the highest investment return for the public."

Researchers say that the most effective way to address traffic congestion varies from one urban area to another, but that in all cases, a multi-faceted approach should be used, relying on more efficient traffic management and public transportation in addition to new construction. Travel options such as flexible work hours and telecommuting should also be part of the mix.

## DAN KNISE, from page 7

**Other insurance concerns.** The workers' compensation loss history of the acquired or merged firm can create its own "tail" issue. Prior claims affect a firm's workers' compensation experience modification factor (EMR), which is based on a firm's loss history over a three-year period and impacts the amount of a firm's premiums directly.

Acquiring a firm with a higher EMR may increase your insurance premiums and affect your ability to win certain jobs as some owners (e.g., petro-chemical) require project participants to have an EMR of 1.00 or below. While exceptions will be made often with proper explanation, there is the real risk of losing business opportunities due to a too high EMR.

Another issue is the need to scrutinize and coordinate carefully listing of "named insureds" on insurance policies going forward after the merger or acquisition. Since being an "insured" establishes coverage under the policy, it is important to ensure that all past and ongoing entities be appropriately named. This is especially true as more and more we are seeing claims arise years, and even decades, after the actual incident or error and after previous insurance policies have long since expired.

Finally, consideration must be given to the financial impact of deductibles and policy audits. Who is responsible if six months from now a bill comes in to cover a deductible on an old claim or a premium due audit is issued on a past workers' compensation policy? Often contingencies are set up at the time of closing just to cover such unknowns. In any event, it is far easier to contemplate such issues on the front-end versus after the transaction is complete and the new organization is moving forward.

Mergers and acquisitions offer firms and their employees great opportunity for reward. At the same time, risk lurks at every corner. A thoughtful risk evaluation and effective action plan for addressing such risks is critical. The best advice: Consider risk early in the process and lean on your risk and insurance advisor/broker for assistance.

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## NEW OFFICES, from page 5

are invested in the area, and therefore invested in our clients."

CobbFendley had the official ribbon cutting with the Pearland Chamber of Commerce in October and received a lot of positive feedback from clients about its accessibility.

"Some would say that the best part about the office is its close proximity to Chick-fil-A, but the opportunity for growth in the area is the office's strongest attribute," Goudie says.

So, what will 2013 bring for CobbFendley? Currently, the firm does not have any plans to open another office this year. However, it is reviewing the viability of some locations outside of Texas for future locations.

"As part of our vetting process, we will review the marketplace to determine the specific need for an office and meet with personnel to find the right person to lead a new office," Goudie says. "CobbFendley is never averse to expanding, but we do work diligently prior to making any commitments to make sure it is the right decision for the firm, our staff and our clients."