

Don't Swim Naked: Risk and Insurance Principles for Your Next Deal

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Principal
New York

- 5+ Years as an A/E/C specialty broker and risk consultant
 - All lines of coverage
 - Alternative risk-transfer mechanisms, including captives
 - Domestic and international exposures
 - Risk-management partner philosophy
 - Tactical advice on future-planning, including M&A and succession planning
- 11+ Years of experience as an A&E attorney
 - Litigated through trial
 - Negotiated thousands of contracts and other transactions
 - Former Associate General Counsel for Skidmore, Owings & Merrill LLP ("SOM")





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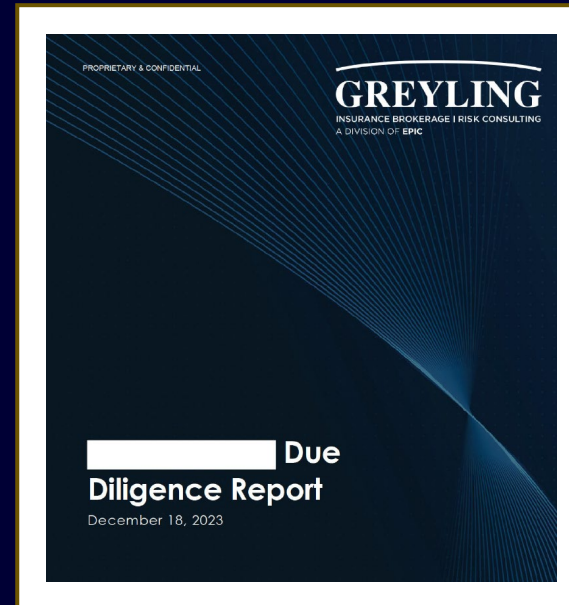
Remote | Alabama | Georgia

- 22-Year Industry Attorney & Risk Management Professional (28-Years in Legal Practice)
- General Counsel for ENR Top-100 Firm (18 Years)
- Construction Risk Insurance Specialist (CRIS)
- ACEC Risk Management Committee
- ABA Forum on Construction Law
- Speaker, AIA Large Firm Roundtable
- ACEC/PAC Millenium Club Member
- Alabama State Bar Construction Law Section President, 2018-2019
- Admitted to the Bar of the U.S. Supreme Court
- Licensed Property/Casualty Broker in all 50 States
- The University of Alabama, B.A., 1995
- The University of Alabama School of Law, J.D., 1998

1 Risk & Insurance Due Diligence

Risk & Insurance Diligence Items

- **Insurance**
 - Adequacy of Seller's program (limits, deductibles, and coverage)
 - EMR evaluation
 - Tail/Nose
 - Identify costs to be included in deal
- **Risk Management**
 - Claims analysis
 - Upstream and downstream contracts
 - Client, project, and subconsultant selection protocols
 - Safety (people and vehicles)
- **Operational**
 - Review managers, directors, and project teams to evaluate quality of operations
 - Culture
- **Who should be involved?**
 - Buyer's leadership and key personnel
 - M&A Consultant/Broker
 - M&A Counsel
 - *Insurance Broker*
 - Finance & Tax Consultant
 - HR, IT, Administrative Consultants



2 Professional Liability ("PL")

PLI: Stock vs. Asset Purchase

Stock Purchase

- Acquiring assets and liabilities, including the existing insurance program.
- Seller is usually rolled into Buyer's program, but Seller's policies can remain active for specific circumstances (e.g., Buyer's insurer will not accept exposure, losses are horrific, mixed stock/asset deal), always subject to applicable change in control provisions requiring carrier consent.
- Legal entity remains intact, so Buyer may be restricted from making substantive changes until the next renewal date, rather than at closing.

Asset Purchase

- Acquiring select assets and liabilities, not the entity.
- Transaction is more complicated and there are several insurance implications to evaluate (more later)
- Underinsured exposure can lead to successor liability on the part of the Buyer

Professional Liability in Stock Purchase

Extended Reporting Period ("Tail")

- **What Is It?**
 - You can report a claim after expiration
 - Covers errors and omissions ("E&O") from retro date to closing
 - Can range from 1 to 5 years
- **Cost**
 - % of annual premium, e.g., standard for 3 years is ~ 200% of annual premium
 - One-time cost at close
- **Considerations**
 - Same limits apply for length of tail
 - Likely no pre-claims assistance
 - Known claims reduce tail limits
 - Buyer's policy excess of tail
 - Who pays the premium?

Full Prior Acts ("Nose")

- **What is it?**
 - Buyer's policy covers Seller's pre-close E&O.
- **Cost**
 - Generally, Buyer's insurance rate times Seller's exposures
 - Generally less expensive than Tail
 - One-time cost at acquisition close
- **Considerations**
 - Seller's claims are subject to Buyer's policy's terms, limits, and deductible
 - Earnout: more exposure to Buyer's program, difference in deductibles
 - Who pays the premium?

Professional Liability in Asset Purchase

- **Perception of Buyer's Officers & Directors**
 - Cheaper, clean break at closing, no Seller liability, and Seller's insurance program is irrelevant
- **Reality of Asset Purchases**
 - Riskier, more complicated, and need more consideration
- **Novation and Assignment of Seller's Contracts**
 - If Seller purchases 3–5 year Tail, any claim brought after expiration is uninsured, incentivizing plaintiffs to pierce corporate veil, which has been successful in the past (more later)
 - Seller's clients may reject contract assignment unless buyer assumes liability for prior acts
- **Recommendations**
 - In certain instances with unique and/or high-risk factors require Seller to maintain practice PL policy
 - Purchase longer tail (5 years) with increased limits
 - Do not assume liability for prior acts by covering unacquired entities on Buyer's PL
- **Considerations**
 - Seller's principals/officers may request personal cover at Tail expiration to protect against personal liability
 - Buyer's practice PL could cover prior acts upon expiration of the tail

Asset Purchase—The Veil Pierced

- Small Seller providing critical services on a large project
- Buyer buys assets
- E&O was known and reported to low-limits eroding PL prior to close
- E&O allegedly caused major damage
- Buyer sued on successor liability theories of “De Facto Merger” and “Mere Continuation” and participated in ultimate settlement
- Factors that can put you at risk as a successor:
 - Known issue (Buyer is not an “innocent purchaser”)—especially where price is discounted
 - Transfer of substantially all assets? In A&E “people are the business”—continuity of management and granting of ownership in Buyer; most key professionals move to Buyer
 - Same clients serviced by same people?
 - Nose coverage at close (why are you covering liabilities you do not intend to own?)
 - New corporate entity with similar name
 - Calling the transaction an acquisition
 - Disregarding corporate formalities

2 Casualty Risk— The Sleeping Giant

Property/Casualty Risk: Overview

- General Principles
 - Occurrence-based: Policy year in which the accident occurred will cover.
 - No Tail or Nose required
 - Extended Completed Operations Endorsement?
- Largest Risk Items
 - General Liability—premises liability claim or third-party action-over
 - Auto Liability—Catastrophic accident where insured is at fault
- Key Takeaway
 - If the Seller has a known claim before acquisition, it resolves after acquisition, and it exceeds the seller's limits, then the buyer is likely responsible for that difference out-of-pocket in a stock transaction, subject to indemnity terms in the PSA.

Two Real Scenarios

Transaction 1

- Engineering ESOP that is very acquisitive
- Acquired utility contractor (true construction means and methods exposure)
- EPIC C&D engaged only for insurance due diligence (pricing and basic coverage)
- Buyer's group captive did not want means/methods exposure because of losses: little to no fleet control (no cameras, telematics, etc.); little to no driver protocols/training
- Loss runs showed several reports with \$0 in reserve. One of the "\$0s" = \$3M post closing.
- Separate program costing \$1M+ per year for many years prior to captive eligibility

Transaction 2

- EPIC C&D engaged to do insurance, risk, and operational due diligence: \$0 on loss run investigated and despite Seller indicating this is a "nothing burger," police report obtained stated "life flight" in the box discussing whether ambulance was called.
- Deal killed

Recommendations

- Due Diligence Recommendations
 - DO
 - Pay special attention to the loss runs but ask specific questions beyond the loss runs
 - Review and scrutinize open claims regardless of reserves
 - Review prior or pending litigation documents regardless of what is listed on the loss runs
 - Heavily scrutinize auto exposures
 - DON'T
 - Ignore claims history or loss runs
- If a Material Claim/Potential Claim is Identified in Due Diligence
 - DO
 - Pause, renegotiate, or terminate deal OR
 - Require settlement before closing
 - DON'T
 - Convert the structure from a stock to asset acquisition
 - Close the acquisition before the claim is fully resolved

3 Cyber & Executive Liability

Other Claims–Made Policies: Cyber, D&O

- Cyber Tail
 - To cover cybersecurity events that may have occurred prior to the acquisition
- Executive Tail
 - Directors & Officers—alleged mismanagement related to the acquisition
 - Employment Practices Liability—harassment/discrimination with newfound “deep pocket”
- Conclusion
 - Tail policies are highly recommended
 - If the seller does not purchase cyber or executive liability, then standalone tails are available

4 Representations & Warranties Insurance (RWI)

Reps & Warranties Insurance

- What is it?
 - Transactional risk insurance that protects Buyer from losses resulting from breach of Seller's representations and warranties contained in the purchase agreement.
- Cost
 - Limits purchased are typically 5%–10% of enterprise value; usually minimum limits are \$3M
 - Premium is generally 2.5%–3.5% of policy limits + ~\$45K underwriter fee; minimum premium = \$125K+
 - Example
 - Enterprise value of deal is \$40 million.
 - Limits at 10% of enterprise value is ~\$4 million in RWI limits
 - Premium at 2.5%–3.5% of \$4M policy limits totals \$100,000–\$140,000 (subject to minimum premium) + ~\$45K underwriter fee
- Considerations
 - Coverage does not extend to known liabilities or issues discovered prior to close.
 - PL Tail coverage vs. RWI coverage
 - RWI does not typically cover professional liability

RWI: Fundamental vs. Non-Fundamental Warranties

- **Fundamental**
 - Core bedrock assurances that Buyer relies upon for transaction
 - Fundamental Warranties are covered for 6 years after transaction
 - Include authority of seller to bind, Seller being in good standing, accurate capitalization, no conflicts or consents, taxes, title to property, and assets
- **Non-Fundamental**
 - All other representations and warranties
 - Non-Fundamental Warranties are covered for 3 years after transaction

When is RWI Warranted for A&E Deals?

- Accounting methodologies
 - Percentage of completion accounting; revenue recognition matters
- International entities & operations & new geographies (licensing, taxes, regulations)
 - Carriers want to understand any work outside of the US
 - FCPA exposure
 - Legal, financial, and tax diligence will be expected in any jurisdictions with material operations
- Client/Project concentration (retirements, changing appetite, local preference, etc.)
- Contract compliance concerns, e.g., MWBE/DBE certification
 - Audits
- New services or technologies
- Quick diligence process/did not interact with all major shareholders
- Professional liability—smaller limits, limited Tail—but often excluded.

Questions?

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Thank You.