

# Mergers & Acquisitions: Insurance & Risk Implications

A Guidance Note from Lockton Companies LLP  
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## Introduction

A merger or acquisition is one of the most fundamental strategic changes that can occur to your business. While no amount of planning and due diligence can ever remove the element of uncertainty/the unknown, considered planning and a well-managed merger strategy can help ensure that the chances of merger success are maximised.

This guidance note provides an overview of the insurance matters to take into account when considering merging with/acquiring another firm.

## Initial Stages

You will already have a clear idea of why you are considering a merger or acquisition. As soon as the idea has crystallised and there is a specific target practice in mind, engage with your professional advisers to ensure your early decision-making processes are fully informed.

Before speaking to Lockton, it would be helpful for you to have considered the following questions:

Issues	Initial Response
When are you intending to merge? (are there any tax issues that require being taken into consideration here?)	
Will you be a successor practice?	
How many partners/members will the merged entity have?	
What will be the work-split of the merged entity?	
What will be the structure of the merged entity (LLP, Incorporated Practice, ABS)?	
Which insurer provides the target practice's PI Insurance?	
How much cover will the merged entity require?	
Do you have cover for any Management Liability issues that the merger process might throw up?	



## Due Diligence

Mergers & acquisitions have a number of insurance and risk management implications that should be considered at an early stage in the decision-making process:

- Undertake adequate due diligence on the 'target' practice (the practice)
- Consider which firm is likely to be the dominant firm thereafter
- Review the claims, precautionary intimations and complaints record of the practice
- Review the Insurance history and premiums of the practice
- Consider the culture of the practice; its locations, departments and its systems and procedures.

How will integration be effected in practice? What risk management implications may arise?

### Practical Steps

1. *Provide the Practice with a template letter of authorisation* (see copy at Appendix 1) to enable Lockton to liaise with the target practice's brokers to obtain the necessary insurance information.
2. *Notify your broker - and other business advisers - at the earliest opportunity regarding a proposed merger.* In order to ensure that the advice is as accurate and useful as possible, disclose as many of the relevant factors as possible. If the proposed merger is still not in the public domain, consider asking your advisers to enter into a confidentiality agreement; agreeing a communications protocol (including the use of a project name for any communications) to ensure that you can obtain the necessary timely advice without prejudicing confidentiality.
3. Your broker will want:
  - to know *the identity of the other firm* in question
  - a copy of the other firm's *last proposal form* (including details of recent years fee income, work splits etc.)
  - *details of its current PI cover* (limit of indemnity, excess, premium, insurer)
  - a copy of the firms *claims history* (ideally for a 10 year period – including predecessor practices), (initially a copy from the previous renewal will suffice, but an up-to-date one should be sought as soon as possible)
  - *timescale* of a likely merger/acquisition
  - *whether all or only part of the target firm will be merging with your practice* (if only part, what will be happening to the remaining part)
  - *any other information* you have regarding the purpose and intended structure of the merger.

## Structuring the deal – an Insurance perspective

While insurance arrangements are not the most significant part of a merger or acquisition, they can often be a more important part of the decision-making process than first imagined.

### Successor Practice

The definition of Successor Practice in the SRA's Minimum Terms and Conditions are complex. You may be a successor even though you did not intend to take on the liabilities of another practice when taking it over or merging with it, even if you specifically agreed that those liabilities would remain elsewhere.

Whenever a practice ceases to be a "discrete business," there is a potential for the *successor practice* rules to take effect.

You may become a successor by holding out your practice, "expressly or by implication," as being the successor of or by incorporating the other practice:

- By taking on the majority of the principals in the other practice as principals in your practice
- By taking on at least one such principal as a principal when the majority have not become principals in another principal
- By taking on a sole practitioner or a recognised body into your practice as a principal or by taking on a sole practitioner as an employee.

### Past/On-going Liabilities (Run-off)

If the entirety of the target practice is being taken on, and will not be an on-going separate discrete business in any form, your firm will be a successor practice, unless the target practice goes into run-off prior to the merger taking place. This will be a commercial decision between the parties. It may not be an attractive option for the members/partners of the target firm - given the cost of run-off (typically 3 times the final annual premium) - however, from the acquiring practice point of view it is the ideal scenario as it reduces any risk of claims arising from historic work of the target practice impacting adversely on the claims history in future. In the worst case scenario, this can severely prejudice the availability of competitive insurance terms.

The position is more complex if the target practice has PII cover above the £2m/£3m compulsory minimum level ('Primary layer'). While 6 years run-off cover is available for the payment of a one-off premium for the Primary Layer insurance, run-off cover for any additional layers is only obtainable on an annual basis. In the event of significant claims impacting on the excess layers, future premiums may be prohibitively expensive or terms simply may not be available. There is therefore very little risk transfer benefit for the on-going practice in obtaining run-off cover for anything other than the Primary Layer.

Ultimately, if you do decide to take on the liabilities of the other practice, ensure that you have undertaken sufficient due diligence. Consider delaying the actual merger, and enter into a transition phase which can help:

- Address any issues arising out of the due diligence
- provide extra time to put together a meaningful risk management document as part of the PII submission
- Establish how systems and procedures can be harmonised.

If the merger can coincide with the PII renewal:

- Additional premiums are not incurred unnecessarily; it may well not be possible to obtain a return on premium for any of the existing policies - so delaying the merger until the next renewal prevents any lost premium paid
- It allows further time to determine the best insurance market for the merged practice's needs, while improving the chances of obtaining competitive terms.

**Foreign Offices**

If the target practice has offices in a foreign jurisdiction, or is itself located in another jurisdiction, the PII implications can be more complex.

**Scottish Practices/Offices**

Certain 'reserved' work (e.g. conveyancing, court work) cannot ordinarily be undertaken by an English regulated practice. This can be addressed in a number of ways. Typically the most attractive are either:

- (i) Retain the Scottish practice as a separate LLP - with separate cover under the Law Society of Scotland Master Policy
- (ii) The Scottish operation could become a separate Scottish-based Multi-national Practice (MNP).

In certain circumstances, the Law Society of Scotland will permit a Scottish-registered MNP to obtain cover through an English firm's PI Insurance, subject to acceptance of an endorsement on the policy.

Lockton will ensure that the correct form of endorsement is used and approved by both the Law Society of Scotland and your existing insurer.

**Conclusion**

Each merger or acquisition will ultimately contain a number of issues specific to that particular case. This guidance note is only a general guide to the basic issues, and does not constitute specific advice that you should rely on. Please contact your Lockton insurance adviser to discuss any matters relating to a potential merger or acquisition in more detail.

