Mergers and Acquisitions and Successor's Liabilities

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Many of today's mergers and acquisitions have a hidden "Russian Roulette feature" which if unaddressed, could prove to be financially fatal years after a deal is completed. Mergers and acquisitions have played a major role in the business marketplace for many years. Many companies acquired other entities with little thought to the potential liabilities that they could inherit which is known as *successor liability*. If they did nothing to protect themselves from future litigation arising out of *successor liability*, these lapses in judgment could come back to haunt them.

With the increase in frequency of catastrophic type claims arising out of products, completed operations and professional liability type lawsuits… executives have become more concerned that there may be a skeleton or two in their closets resulting from *past* mergers or acquisitions. They wonder where the next asbestos or defective construction lawsuit will come from. In fact, a firm recently found itself in the midst of a product liability class action lawsuit from silicon products that had been manufactured by a company that it acquired. These products were used in conjunction with breast implants and this resulted in a much-litigated situation with expensive damage suits and settlements. Companies contemplating mergers or acquisitions have an opportunity to protect themselves against the pitfalls of successor liability.

Acquirers have the opportunity to mitigate much of the unknown and unforeseen risk through insurance protection that would provide monetary coverage for potential losses from future liabilities. The warning is that the insurance coverage is truly effective only when it's part of a systematic pre-merger due diligence strategy that includes a well-drafted buy/sell agreement that clearly assigns responsibilities to the acquirer and the acquired.

Seeking solutions prior to final handshake may enable companies to avoid or minimize the financial cost of lawsuits. Even those companies that have been through a merger or acquisition and haven't had any liability claims give serious consideration to protect themselves against the unknown liabilities of *successor liability*. The determination of who will be responsible for liabilities arising out of past activities of the acquired company more often than not can be difficult and seem unfair, but must be addressed up front and with great care and circumspection…through the due diligence process.

A number of factors must be considered in assessing liability arising out of the merger or acquisition. This information can only be obtained by gleaning the facts surrounding the entire acquisition and the subsequent conduct of the parties in terms of the purchase/sale agreement…. This is what was formerly known as the *buy and sell agreement*. The structure of each company's insurance policies will also determine who is going to be responsible… particularly when it comes to the deep pocket syndrome.

A successor liability claim may manifest itself in many different ways. It is critical that companies develop a well-rounded plan for managing liabilities associated with mergers and acquisitions that address all of the factors mentioned previously. Prudent measures should be used by the successor company prior to completion of the acquisition. Again… a thorough due diligence investigation can alert corporate executives and their legal counsel to previous or current exposures to liability. A proper due diligence process can help identify and quantify products that have been manufactured or services rendered (prior) to the merger or acquisition and allows an opportunity to properly access those exposures. The result of the due diligence process can significantly influence the value of the transaction if the successor company agrees to accept liability for products or services rendered in the past.

During the due diligence process… legal counsel and risk management professionals should review the insurance records along with the claims history and carefully review the products and services rendered by the company being acquired. Since many of today's liability claims involve products or services rendered or sold many years ago, its important to locate and preserve insurance policies that may have been purchased even decades ago by the predecessor company. These policies may prove to be very valuable by providing coverage for future claims and a thorough due diligence examination may also reveal trends or defects of which the successor company should have been aware.

As was indicated before…the purchase/sale agreement plays a very important role in establishing the companies first line of defense against lawsuits. The successor company should work closely with legal counsel to make sure that the purchase/sale agreement is drafted in such a way to make sure how responsibility between the parties is allocated properly. Additionally, it is important that the allocation is compatible with the triggering of the successors and the acquired company's liability coverages.

Insurance companies are very sensitive to mergers and acquisitions and its incumbent potential exposures. Without any special agreement in advance their policies will more than likely exclude coverage for this successor liability. To address this concern, the new extended reporting period policy being used in conjunction with a thorough due diligence investigation and a carefully structured purchase/sale agreement may offer the type of protection required. Successor companies that have not explored ways of reducing or eliminating exposures to successor liability lawsuits are playing "Russian Roulette."

In addition to products, completed operations professional liability coverage where applicable, there are other insurance coverages available to meet merger and acquisition exposures:

- **Representation and warranties coverage** protects the seller company against disputes over alleged breach of specific representations or warranties in the purchase/sale agreement. The typical representations and warranties would include such items as accounts receivable — employee benefits — financial statements — intellectual property and taxes.
- **Tax opinion guarantee insurance** may be available if the deal depends on specific tax treatment. This is especially important if the tax authorities were later to rule against the treatment and the expectation called upon in the due diligence and the reason that the merger/acquisition was made, could be adversely affected. Tax opinion guarantee insurance pays in the event of unanticipated taxes which may be owned as a result of a ruling against a specific tax strategy which was used for the merger or acquisition.

Bid cost insurance reimburses for fees that must be paid to various external advisors originally retained to facilitate an aborted deal. The deal may fall through as a result of failure to receive regulatory approval or loss of financing.

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NOTE: This Guest Essay is a partial reproduction of an article by John Cavanaugh of the Executive Risk Department of the Chubb Group of Insurance Companies, with updated contributions by Meade Collinsworth, CPCU, ARM, President of Collinsworth Alter, et al., of Miami Lakes, Florida.

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