

Construction M&A: How to Avoid Post-Deal Indigestion

The global construction market is booming – from housing, hotels and resorts to mega-projects such as the recently announced Red Sea Crossing and the widening and deepening of the Panama Canal. As design and construction firms struggle to keep up, one response that is becoming more common is a merger or acquisition.

For most design and construction industry executives, consummating a merger or executing an acquisition is not an everyday occurrence and is undertaken with much caution and uncertainty. Anecdotal evidence indicates that the majority of design and construction industry deals fail to deliver the value that was projected during the feasibility and due diligence processes, and that many company executives must tolerate a protracted period of post-deal indigestion.

We strongly encourage clients involved in merger and acquisition activity to adopt an underwriting approach as they evaluate potential target companies.

Professional services firms must also contend with the issues surrounding the real possibility of a claim being brought – after the deal is complete – for the past acts, errors or omissions of the merged or acquired firm. While the mechanics of responding to such a claim can be addressed through the deal structure (asset versus stock acquisition, run-off and tail covers, etc.), we strongly encourage clients involved in merger and acquisition activity to adopt an underwriting approach as they evaluate potential target companies.

An underwriting approach will help the acquirer obtain a fully rounded understanding of the risk management and loss prevention culture within the target firm and quantify the potential financial impact of an unforeseen Professional Liability claim.

The following checklist of dos and don'ts will help you underwrite a target company.

Do

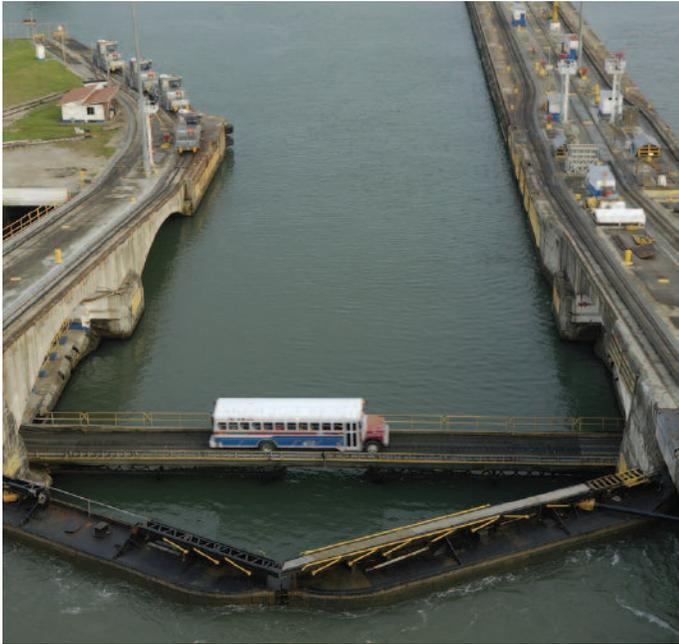
- Consider three-year projected estimates of insurance premiums for the combined entity and benchmark against your peer group using accepted market data
- Consider the financial impact and collateral requirements of increasing self-insured retentions and deductibles



Professional Liability Newsletter for the Design and Construction Industry

. . . people whose work revolves around construction management should be aware of the variable range of exposures they could face.

- Closely review any “change of control” clause implications of the target’s insurance policies
- Review six to twelve years’ claims experience to identify any claim trends of concern – in terms of both frequency and severity



- Determine the target’s losses from the ground up and identify claims costs incurred by the target within its self-insured retention or deductible
- Confirm that asset valuations are current to confirm the appropriateness of sums insured to prevent under-insurance
- Review and quantify any contingent liabilities and consider methods to minimize or insure against them

Don’t

- Rely on the quantification of future insurance or claim costs by non-qualified consultants
- Forget to review the financial worthiness of the target’s past liability insurers for those insurance lines which are “loss occurring” and which may have to be accessed post-deal in the event of a loss or claim
- Assume access to your current Professional Liability carrier’s program – or its current terms and conditions – post-deal
- Assume that there will be any return premium post-deal
- Overlook uninsured risks

Companies of course don’t turn to mergers and acquisitions every time their capacity is stretched. Other responses include:

- Increasing investment in technology and integration
- Establishing joint ventures and other project-specific entities to compete for and deliver projects
- Outsourcing to offshore locations that have the resources to perform the work – and often for less cost

These approaches come with their own risk management issues, which will be the subject of future commentary in this space.

Contacts

For more information, please contact:

David Grigg
212 915 8171
david.grigg@willis.com

Melody Wofford
615 872 3475
melody.wofford@willis.com

