

Mergers & Acquisitions

The mergers & acquisitions group is comprised of professionals whose sole focus is responding to the transactional demands of our clients. Through our global service model, we have the ability to respond to transactional issues anywhere in the world. Currently, Willis has in excess of 40 professionals that are fully dedicated to handling the preclosing diligence needs of our clients. Our centers for M&A activity are based in New York, London, Paris, Munich and Milan. The Willis team has participated in more than 2,000 transactions. This experience gives us the ability to deploy resources swiftly in a transactional environment in an effort to overcome obstacles and accurately determine the insurance effects on the enterprise value of potential investments. Our team also draws from a wide range of backgrounds, including underwriting, brokerage, risk management, accounting and legal. Therefore, our input on a deal comes from many different perspectives.

The Willis Mergers & Acquisitions model is structured so that we work with you as an integral participant across a wide range of issues and concerns to create value in each phase of a transaction lifecycle. Our goal simply stated is to increase the value of our client's investments. We achieve our goal by focusing on these areas:

- I. Pre closing due diligence
- II. Deal facilitation through insurance products

Pre closing due diligence:

An insurance and risk management assessment of the target company's operations is conducted during this phase. Our mission during the diligence process is to:

- review risk and contractual issues that will prohibit the successful implementation of the post closing business model
- assist in accurately valuing the target enterprise
- create long term investment value through the use of insurance programs that stabilize cash flows, protect the balance sheet and enhance a liquidity event should one occur

We accomplish our pre closing mission by focusing the impact that risk will have from a financial, legal and risk management perspective.

Financial:

Identifying the accrual methodology utilized for recognizing insurance obligations on the balance sheet and the resulting impact on net working capital

Determining the effect that assumed liabilities and escalating/ pyramiding collateral obligations will have on the credit facility

Maximizing post closing cash flows by forecasting future funding of historical obligations

Outlining what expenses have been running through historical financials and whether trailing EBITDA is over – or – understated

Legal:

Analyzing the purchase and sale agreement to assess insurance obligations and identify the funding or coverage mechanisms available to satisfy these obligations

Determining what impact insurance representations and warranties will have on the buyer and seller

Assessing legacy liabilities of targets by investigating historical purchases, divestitures and operating capacities

Highlighting the insurance provisions in credit agreements and loan covenants to determine their impact on the ability of the company to recover claim payments in the event of a loss

Addressing insurance coverage issues created by a “change of control event” (Directors & Officers Liability, Fiduciary Liability, Employment Practices Liability, Professional Liability) and the subsequent impact on the buyer and seller

Risk Management:

Performing a complete analysis of current and historical insurance placements to identify coverage deficiencies, underwriting insolvencies/down grades, aggregate limit breaches and erosions

Evaluating claim trends and their impact on future operations

Quantifying the cost to integrate the target company into the buyers program

Determining whether a standalone program structure should be pursued due to risk issues inherent in the target company’s business.

Deal Facilitation:

As the transactional process evolves, there may be situations that create an impasse between buyers and sellers. During our deal facilitation process, the Willis team will evaluate whether an insurance product can be utilized to remove and quantify these obstacles. Products that we frequently utilize during this process are:

- Representations and Warranties coverage
- Tax treatment coverage
- Environmental coverage
- Litigation caps
- Loss portfolio transfers
- Successor liability coverage

A brief explanation of this coverage's is provided below.

Representation & Warranty Insurance

M&A transactions generally require indemnification by the seller for breaches of the representations and warranties made in the purchase agreement. The representations and warranties may require that a material percentage of the indemnification be held in escrow. The seller or buyer may object to this arrangement, for example, when the seller does not want to maintain an escrow account or the buyer wants more protection than the seller will provide. A Representations & Warranty insurance contract can be structured to respond in lieu of an escrow or in replacement of or excess of the indemnity obligations.

This coverage can allow **accelerate** the distribution of funds to the seller that would ordinarily remain in escrow. This can be of particular value in private equity firms' portfolio companies as freeing these funds can have a direct impact on the investors' IRR. These policies are highly manuscripted contracts. With proper guidance from an insurance broker experienced in negotiating these placements and legal counsel, significant modifications can be made to meet the needs of buyer and seller in placing coverage.

Tax Treatment Insurance

The feasibility of many corporate transactions (M&A, LBO's reorganizations, etc.) may depend upon a specific tax treatment model. If the IRS were to later rule against the basis upon which the transaction is built the transaction could be adversely affected. This coverage insures against the financial impact of an adverse ruling of the tax basis on which a specific transaction is based.

The prospect for favorable tax treatment is often a deciding factor in the success or failure of many corporate transactions. Tax Opinion Liability Insurance can help a company reduce or eliminate an unwanted contingent liability arising from a successful I.R.S. challenge to a company's tax treatment of a transaction or investment. We can place coverage giving insureds protection against tax losses that may arise in spite of a favorable tax opinion. The policy provides that if the insured receives an adverse tax ruling benefit, the carrier will indemnify the insured for the full amount of any tax loss sustained, plus certain specified ancillary expenses.

Loss Mitigation

Open, uninsured or under-insured litigation of any type can prevent a buyer from accurately determining the potential liabilities they will face post closing. The uncertainty surrounding future liabilities often presents unacceptable risk. A specific risk management evaluation prior to closing a transaction is an important component of due diligence and is needed to develop solutions to address risks that may affect a company's valuation.

The insurance market has responded with several innovative approaches termed "Loss Mitigation," "Contingent Liability," or "Post Event" contracts that include risk transfer of these liabilities on a "first dollar" or a "cost cap" basis to reduce or eliminate the uncertainty. Generally, an insurance product transfers risk of existing or expected litigation for a premium, which is often considered an expense at deal closing. The risk is transferred to an insurance carrier. This eliminates the risk from the target company's

balance sheet, and the uncertainties of open liabilities. The two basic approaches are as follows:

- An adequate reserve is determined for insurers by an independent firm of lawyers, actuaries or other professionals and the insurers then offer conventional insurance in excess of the reserve amount plus a self-insured cushion. This type of insurance is usually arranged on a pure “risk transfer” basis with some premium adjustment to reflect a “no claim” situation.
- The insurer will review the circumstances of the reserved item and may then offer to guarantee an amount of the reserve for a premium and in doing so provide full indemnity from the “ground up” for anything that may flow from the item concerned. In such cases much of the structure will be on a “finite” basis so “profit sharing” becomes an important feature.

Future due diligence is much less complicated when the target company is brought public or spun-off when these liabilities are contained through insurance. Properly structured, these loss mitigation products also can provide preferential tax treatment since they are considered risk transfer insurance policies.

These programs address risk arising from litigation in areas including shareholder (securities), environmental, employment practices, general liability, and patent infringement. Generally, litigation with expected valuation in excess of \$5 million is necessary to get the attention of select insurers offering this product.

Loss Portfolio Transfers

Prospective acquiring companies often find that a target company has maintained many years of self-insured insurance programs or has purchased insurance products with either high deductibles or self-insured retentions. Insurance accruals on the financial statement are often inadequate and understated. It is difficult to value a company’s worth with these open liabilities. Loss portfolio transfers offered by insurance carriers convert these open liabilities for a single premium payment. The target company on a post-closing basis is no longer in the insurance business and can divert resources to other core areas for strategic growth. Loss portfolio transfers convert high deductibles to traditional

guaranteed cost insurance arrangements shifting the financial and administrative burden to an insurer.

Successor Liability Coverage

A target company's prior acquisition history and assumed liabilities have historically caused some transactions to terminate. Successor liability insurance protects an acquiring company when the buyer discovers that the target company has made many prior acquisitions and divestitures in the past. The liabilities assumed under these transactions are often unclear and present a buyer with potential losses assumed by the seller for each of these prior transactions.

Successor liability insurance has been developed to provide an insurance contract to protect the buyer against the uncertain assumed liabilities of a target company's acquisition or divestiture history. The unknown exposures to loss are transferred to an insurance carrier. The uncertainty of losses arising from assumed obligations of the target company's prior acquisitions is eliminated. This policy remains in place as occurrence coverage and becomes an asset to the buyer upon exit or spin-off, adding value to the newly acquired company.

Environmental Liability Insurance

Environmental risks are sometimes difficult to quantify and they are also difficult to classify because the group of exposures referred to as "environmental" are, in actuality, comprised of a variety of different risks that are related to the release of contaminants into the environment. These risks include the following:

- The risk that a property that is currently or previously owned by the acquired entity has been contaminated by a release of a toxic or hazardous substance that

may result in third party claims of bodily injury or property damage and may require remediation.

- The risk that the acquired entity is a Potentially Responsible Party (PRP) for hazardous wastes deposited at third party disposal sites under the joint and several liability rules of CERCLA.
- The risk that a contaminated property will lose a portion or all of its market value as a result of pollution. This may not only represent a problem for the acquiring entity, but also for financial institutions that hold mortgages or other financial instruments secured by a contingent interest in the contaminated property.
- The risk that a contaminated site that is acquired will require remediation.

Environmental insurance can cover many of these and other pollution risks. Policies can be designed for specific materials or specific activities such as asbestos abatement, underground storage tanks, agricultural chemical applications, landfill operations, transportation of hazardous materials, and wide variety of others. Such policies that are of particular interest in merger and acquisition activities are discussed below.

Pollution Legal Liability Insurance

Pollution Legal Liability coverage provides on-site cleanup for hazardous material releases emanating from pre-existing conditions and can include on-going operations. The coverage provides protection from third party claims (and defense costs) for cleanup, bodily injury, property damage due to releases that emanate from pre-existing conditions and current operations.

This insurance is typically used to facilitate transactions involving property with known, unknown, or suspected contamination. These policies can be used in place of indemnity agreements in sale and lease transactions. These policies are often written to provide coverage to buyers, sellers and lenders.

Cleanup Cost Cap Insurance

The Cleanup Cost Cap policy indemnifies the insured for financial losses that arise when the anticipated cost of a remediation project is exceeded. The policy would cover cost overruns in situations where actual contamination is greater than that which was estimated and also where new contaminants are found during remediation.

The Cleanup Cost Cap policy is designed to address the risk and uncertainty associated with beginning an environmental remediation project – it essentially acts as a stop-loss policy. This mechanism is crucial to investors purchasing contaminated properties as well as to current owners who are cleaning up non-operational assets.

Secured Creditor Insurance

The Secured Creditor policy provides coverage for a loss arising from default on a commercial real estate loan accompanied by an environmental condition. The policy pays either the outstanding balance of the loan or cleanup costs whichever is less. The policy also covers third party bodily injury, third party property damage and cleanup costs. The Secured Creditor policy is designed to give financial institutions protection against loss of collateral value and liability due to environmental problems at foreclosed properties.

Blended Risk Financing & Risk Transfer Programs

Recent developments in the insurance market have resulted in programs that combine insurance and risk financing that can allow corporations to remove from their balance sheet environmental liabilities related to historic problems. Money that has been earmarked for cleanup can be utilized to set up a fund through an insurance structure that works in conjunction with Cost Cap and Pollution Liability Insurance to form a single program so that all dollars paid into the program are considered insurance premium payments. Typically such programs are designed with a commutation account to which premiums are paid and from which actual claims or losses are deducted. This provision is carefully designed to respond to tax, accounting and financial reporting considerations.