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MERGER MANIA HITS TELECOM:

Opportunities Abound, but so do Risks

In a sense, it seems everything old is new again. Some twenty years after the breakup of Ma Bell, the latest string of mergers in the telecommunications industry have led to cries of “foul” from consumer advocates wary of monopolization. However, today’s telecom landscape bears little resemblance to the 1980’s. Federal regulators have helped to promote innovation and growth by allowing businesses to join forces and enhance their capabilities through economies of scale and complementary offerings. We live in a world of voice, data and Internet service providers, each supplementing (and sometimes supplanting) the other in terms of the range of benefits to customers. Voice over Internet Protocol (VOIP) and fiber-optic television providers are blurring the lines that once defined spheres of influence within the industry. Additionally, the increasing sophistication of wireless devices have transformed the “cell phone” into a mobile computer, digital camera and personal entertainment system, all neatly fitting in the palm of our hands.

Beyond this sea change lies another, less-publicized development. *Every merger and acquisition carries with it the exposures of each party to the transaction.* Granted, some mergers are more perilous in this regard than others. The recent acquisition of a former telecom giant newly emerged from bankruptcy carried with it some measure of assurance to the parent company that its new subsidiary’s risks were definite and knowable. However, the general expectation should be that both the would-be parent and its subsidiary will have exposures that are difficult to map.

Check Parent Company’s Coverage for Newly Acquired Subsidiaries

Executive liability insurance policies typically contain exclusions for claims arising against a business unit acquired by the insured while the policy is in force. From an underwriting standpoint, this is understandable – a carrier needs to know what risks it is insuring up front. Often the insured can get an endorsement for automatic coverage of acquisitions below a certain threshold – say, 10% of the parent’s market capitalization on a Directors and Officers Liability policy, or 20% of the parent’s workforce on an Employment Practice Liability policy. Today’s acquisitions, however, frequently involve target companies with fundamentals well beyond these thresholds.

As a result, the new parent may need to continue some or all of the subsidiary’s current Employment Practice Liability and Professional Liability coverages, and take up the issue of a consolidated policy at renewal. As respects Directors and Officers Liability and Fiduciary Liability, it is not uncommon for the new subsidiary company to purchase a “run-off” policy from its previous carrier for a set period of time, up to six years.

What's in a Claim?

Even when an endorsement affords coverage for the new subsidiary, another important factor to consider from a risk management standpoint is the claims management protocol employed by the subsidiary. Some insurance policies require that every notice of circumstance be reported, while others allow some latitude in reporting demand letters or administrative proceedings, with only full-blown litigation triggering the reporting requirement. The frequency of reporting may vary as well; claims may be reported continually or through some periodic "bordereau" process. Because of these variations, the parent company needs to review the subsidiary's unreported claims and circumstances in order to ensure compliance with the parent insurer's policy. The danger for the parent company is that a nascent claim that went unreported by the old subsidiary may subsequently be declined coverage by the parent company's insurer for failure to report the claim within the policy period applicable to the parent company.

New Synergies Create New Exposures

Consider, too, the possibility that the newly acquired subsidiary may fundamentally change the risk profile of the parent company. A landline company purchasing a small Internet Service Provider in order to bundle subscription plans to consumers may now have to concern itself with media liability, since it has become a purveyor of content. Likewise, a cable company that picks up a chain of wireless retailers assumes the advertising injury and intellectual property risks associated with this new revenue stream. Choosing a broker with experience managing risks in the telecommunications industry can help you identify and account for these exposures as your company diversifies.

Revolutionary

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