



Arthur J. Gallagher Risk Management Services, Inc.



Insurance Issues in M&A Transactions

Presented to:

Long Term Care / Legal Risk Committee

Presented by:

Donna Ferrara, Esq.

Arthur J. Gallagher Risk Management Services, Inc.



Preliminary Questions

- What are we trying to accomplish in this deal?
 - Does the deal fit the description –
 - Asset sale?
 - Stock Sale?
 - Investment?
- What kinds of insurance are important?
- What questions should I ask?



- The deal documents do not bind non-parties
 - Unless the insurer agrees, nothing in the deal documents will change the policy
 - Insurers do have provisions which give flexibility to insureds, but don't take them for granted
- Insurance policies can be “manuscript” – that is, unique to the risk
 - Review of *actual* policies is necessary
- Policies may or may not terminate at closing
 - Most often, coverage will not protect actions after change of control
 - Change of control is defined in the policies



Deductible, Retentions and Co-Insurance

- Types of finance risk transfer
- Deductibles and retentions must be exhausted by losses covered by the policy
- Co-Insurance: Can be a specific policy provision, or applied by operation of law
- Workers' Compensation and General Liability can be written on an "audit" or "retrospective rating" basis
 - More a financing mechanism than insurance
 - Contractual arrangements can be complex



Comprehensive General Liability

- Covers claims of Bodily Injury and Property Damage by Third Parties
- Can be Claims Made or Occurrence
- Can pick up contractual indemnity agreements made **before** a loss
- How will indemnities be treated?
- What are significant exclusions?
 - Pollution
 - Intentional Acts
 - Indemnification after loss



Property Insurance

- First Party Coverage for financial interest in tangible property
- May cover contractual indemnification made **before** loss
- Should be replacement coverage, but that does not guarantee unlimited dollars
- Business Interruption
- Subrogation Issues
- Loss Payees vs. Additional Named Insured
- Coverage required by contracts may not be provided by policies.

Directors' & Officers' Liability



- Claims-Made coverage which cover financial risks, not bodily injury, property damage
- Covers personal liability of the duly elected directors and officers (not shareholders or others unless specifically added)
- May provide coverage for the corporation, depending on policy
- Not an “all-risk” coverage. Coverage may be “allocated” between covered and uncovered claims or defendants
- Issues:
 - During transaction, directors, senior management and major shareholders may discover conflicts of interest
 - Indemnification and Employment Agreements may demand broader protection than the policy
 - Coverage varies widely among policies
 - Many exclusions and conditions

Errors & Omissions



- Claims made coverage which protects from liability to third parties for professional negligence
- Coverage varies widely among policies
- Issues:
 - Who is an Insured?
 - What is a Professional Service?
 - How does the deal change that?
 - What are the exclusions?
 - Contractual Liability
 - Insured versus Insured
 - Prior Acts/Prior Claims

Employment Practices Liability

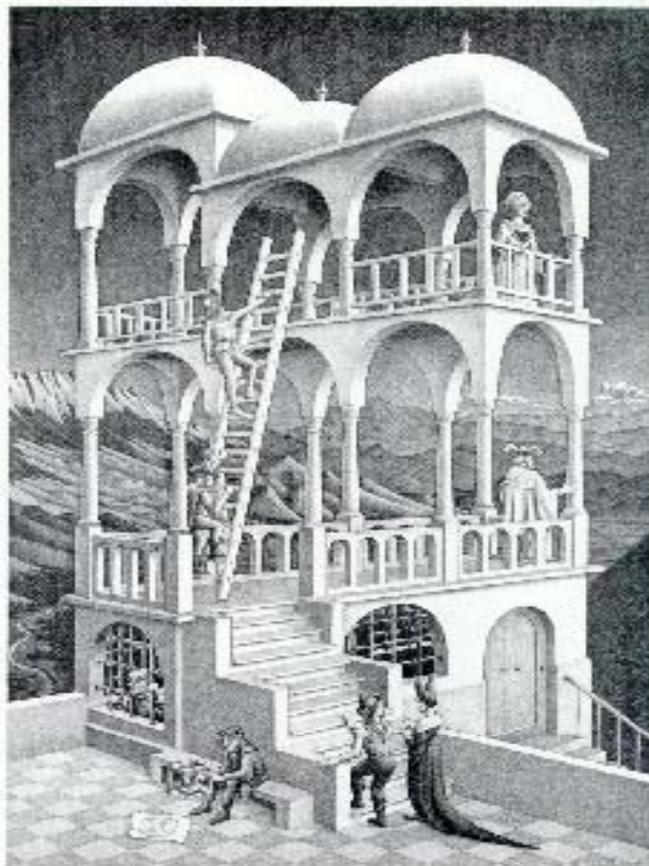


- Coverage for claims by employees and, sometimes, Third Parties
- Commonly includes protection for claims of
 - Discrimination
 - Harassment
 - Hostile Work Environment
 - Failure to Promote
 - Illegal Hiring Practices
- Issues
 - Who is an employee?
 - When is a claim made?
 - Definition of claim can include EEOC procedures, written demand for money or other relief
 - Policy might terminate on closing, before insured is aware of claim



- An important new area of insurance
- Worthy of its own presentation, which will be provided by Joe in next section

Drafting the Impossible...



....Or easier said than
undone.

Two Examples



Insurance Provision in Contract of Sale

Sale of Business
Business Premises
and Liability are fully
insured

Seller promises to maintain all current insurance, with the same terms and conditions for at least three years.

What's Wrong With This Provision?



- Seller is promising to maintain insurance for something in which it will no longer have an insurable interest
- Seller might not want its risk management profile to be constrained by property it no longer owns
- Seller will breach this representation immediately upon closing
- Most importantly:
 - It doesn't help Buyer at all

What Did Buyer Really Want?



- This provision was found in the purchase of a book of financial consultants' business
- The Buyer was taking on some of the Seller's employees, as well as its office space and didn't want to face liability for actions of the prior owner
- Solutions:
 - Run-off policy
 - indemnity agreements
 - Buyers' own insurance
- Carriers must be notified of what the agreement says

Drafting the Impossible (or at least Improbable)



- Deal is for one division: Seller remains in business
- Buyer finds Seller's captive insurance program is better than its own
- Deal documents:
 - Seller will maintain its captive
 - Seller will offer Buyer insurance from captive "on same terms and conditions"
 - Insurance will remain in effect for X years
- Captive management and reinsurers not consulted

What's Wrong With This Picture?



- Captive is a separate company, despite ownership interest of Seller
- Its business model or applicable regulations may not permit accepting Buyer
- Captive has underwriting guidelines which are important to its reinsurers
- Reinsurers of captive may not want to extend their risk to a new entity

The Result?



Digital Risk
protection vulnerability
Privacy Security

M& A Issues of Particular Interest to Long Term and Health Care, Examples



- Licenses – Appropriate licenses are a condition to certain insurance. Federal, state and local law affect transfer or termination.
- Prior Commitments: Agreements can come back to haunt
 - *Lloyd Noland Foundation* – a web of disputes spanning eight years arising from the agreement by one provider to, *inter alia*, reserve 100 long term care beds for Seller’s use. Subsequent sale of the facility led to disputes over classification of beds, state regulation, licensing, contract law and many other issues. (One court described a related case as “a sordid example of numerous law suits arising from the transactions described”. *Lloyd Noland Foundation v. Tenet Healthcare, et al*, 2004 U.S. Dist. LEXIS 30597)

M& A Issues of Particular Interest to Long Term and Health Care, Examples



- Peer Review, Hospital Privileges: How will the transaction affect pending or completed peer review or other work issues?
 - Decisions of one party to grant or deny privileges or services, may lead to actions against the other. *Mazen Abu-Hatab v. Blount Mem'l Hosp., Inc.*, 2009 U.S. Dist. LEXIS 28239 (doctor denied privileges brought action alleging First Amendment Violations, antitrust, violation of Due Process, etc. Although not a merger case, it demonstrates the type of case which can arise).

- Financial Competition Provisions: How will ownership of outside services be treated? Do Buyer and Seller have similar restrictions?

- Long Term Care Insurance: Relatively new benefit gaining popularity. How do parties treat residents with such coverage?



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HACKED: Risks & Exposures of Healthcare Information

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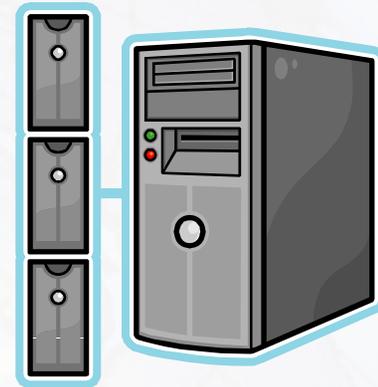
Presented by:

Joe DePaul

Arthur J. Gallagher Risk Management Services, Inc.



The material presented in this presentation is not intended to provide legal or other expert advice as to any of the subjects mentioned, but rather is presented for general information only. You should consult knowledgeable legal counsel or other knowledgeable experts as to any legal or technical questions you may have. Further, the insurance discussed is a product summary only. For actual terms and conditions of any insurance product, please refer to the policy.



According to the FBI
Identity Theft is the fastest
growing white collar crime
in America!



THE NETWORK:

*Where Personally
Identifiable Information
is stored Electronically*



THE WORKSPACE:

*Where Personally Identifiable
Information (Electronic/Non-
Electronic) is stored outside of the
Network*





How is an Organization Vulnerable?

Sometimes Security & Procedures Fail



- Failure of your Network to prevent unauthorized access or unauthorized use of your network (hackers, rogue employees)
- Failure of your Network to prevent malicious code
- Failure of your Network to prevent denial of service attack
- Failure of your Network, your Privacy Policies, and/or your Independent Contractors (Information Holders) to safeguard private information (electronic/non-electronic) in your care, custody, or control

Lost Data Types

- Account Information
- Personally Identifiable Information (PII) & Personal Health Information (PHI)
- Trade Secrets/Client Lists

The most vigilant Network Security and Privacy Policies are Vulnerable to Hackers, Rogue Employees, Social Engineering, and Human Error



- **IT Perspective**

IT Depts. are faced with the challenge of balancing the demands of safeguarding the network and information while adapting to ever-changing technologies

- **Employee Perspective**

Employees are faced with the challenge of balancing work flow needs with safeguarding the confidential information used to perform their job

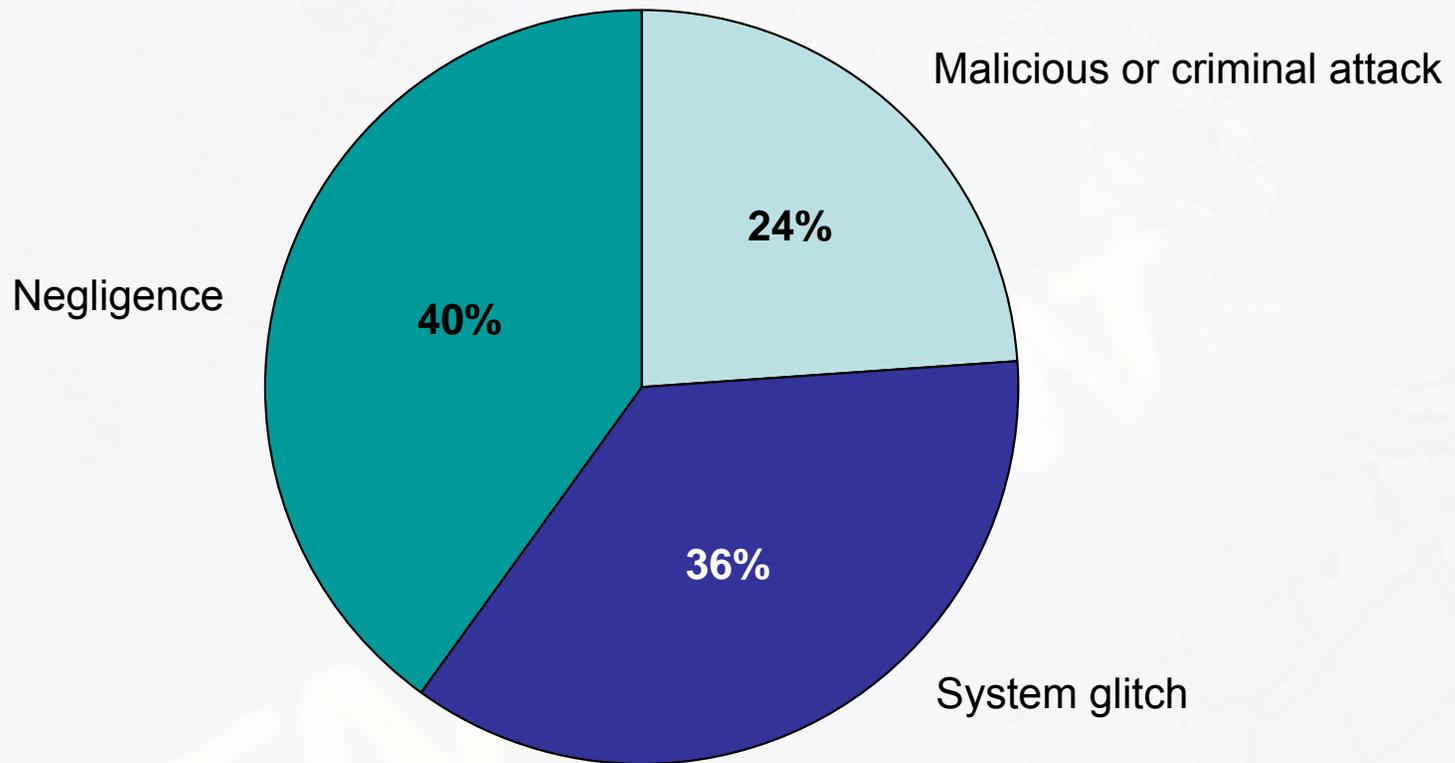
- **Do More with Less**

By product of the economy



Statistics

Sources of Security and Privacy Breaches



High Frequency Industries



2009	2008	2007	2006
498 Publicized Breaches Reported Annually 222,477,043 Records Exposed	656 Publicized Breaches Reported Annually 35,691,255 Records Exposed	448 Publicized Breaches Reported Annually 127,000,000 Records Exposed <i>(94 Million from TJX incident)</i>	315 Publicized Breaches Reported Annually 20,000,000 Records Exposed
2009 Breaches by Industry:	2008 Breaches by Industry:	2007 Breaches by Industry:	2006 Breaches by Industry:
Financial/ Banking: 11.4% of Breaches 0% of Records	Financial/ Banking: 11.9% of Breaches 52.5% of Records	Financial/ Banking: 7% of Records 6.9% of Records	Financial/ Banking: 8% of Breaches Unavailable: % of Records
Educational: 15.7% of Breaches 0.4% of Records	Educational: 20% of Breaches 2.3% of Records	Educational: 24.9% of Breaches 1% of Records	Educational: 28% of Breaches Unavailable: % of Records
Government/Military: 18.1% of Breaches 35.7% of Records	Government/Military: 16.8% of Breaches 8.3% of Records	Government/Military: 24.7% of Breaches 6.4% of Records	Government/Military: 30% of Breaches Unavailable: % of Records
Medical/Healthcare: 13.7% of Breaches 5.1% of Records	Medical/Healthcare: 14.8% of Breaches 20.5% of Records	Medical/Healthcare: 14.5% of Breaches 3.1% of Records	Medical/Healthcare: 13% of Breaches Unavailable: % of Records
All Other Business: 41.2% of Breaches 58.9% of Records	All Other Business: 36.6% of Breaches 16.5% of Records	All Other Business: 28.9% of Breaches 82.6% of Records	All Other Business: 21% of Breaches Unavailable: % of Records



Exposures

Regulatory Landscape



- **HIPAA / HITECH / Red Flags**
 - **Standard for smooth, consistent, and secure electronic transmission of health care data.**
 - **PHI – Confidential, personal identifiable health information about individuals that is created by an health plan, provider, or health care clearinghouse and is transmitted or maintained in any format.**
 - **PHI includes written documents, electronic files, and verbal information. (Even information from an informal conversation can be considered PHI.)**
 - **Examples of PHI include:**
 - **Completed health care claims forms**
 - **Detailed claim forms**
 - **Explanations of benefits**
 - **Notes documenting discussions with plan participants**
 - **Business Continuity Plans/Disaster Recovery Plans**

Regulatory Landscape



- **Graham Leach Bliley**
- **Sarbanes Oxley**
- **46 State Privacy Laws**
- **Federal Privacy Laws**
 - **Federal Trade Commission**
 - **Fair And Accurate Transaction Act of 2003 (FACTA)**
 - **Section 15 U.S.C. § 1681c(g) of FACTA limits the information that can be printed on an electronically printed credit card receipt to the last five digits of the credit card number, and specifically prohibits printing a credit card's expiration date on the receipt.**
 - **Proper disposal of consumer report information required. "Consumer information" under FACTA includes records that are consumer reports and records that are derived from consumer reports**
 - **FACTA Regulation 114 – "RED FLAG RULES"**
 - **The rules implementing section 114 require each financial institution or creditor to develop and implement a written Identity Theft Prevention Program (Program) to detect, prevent and mitigate identity theft in connection with the opening of certain accounts or certain existing accounts.**
 - **December 31, 2010**



Event/Response Costs

- Attorney fees, including:
 - Investigation
 - Notification
 - Guidance
 - Defense/e-discovery
- Indemnity payments
- Notification costs
- Card re-issuance
- Credit monitoring
- Call center support
- I.D. theft insurance/training
- Public Relations

Costs Of A Breach:

- \$204 average cost per record
- \$6.75M average cost per breach
- 14% average cost to defend a claim, per breach
- \$613,000 to \$32 million, total cost range of a breach

Network and Privacy Insurance Gaps in Traditional Insurance Coverages



- **General Liability:**

- Impaired access liability
- Product disparagement
- Customer injury suits
- Wrongful or offensive web content
- Channel attack liability
- Banner advertising
- *Copyright or trademark* infringement
- Domain name (trademark) disputes
- Misuse of *meta tag* language
- Misuse of *framing* or linking

- **Property:**

- No direct physical loss to tangible property
- Misappropriation of a record
- BI and EE

- **Professional Liability:**

- Strict definition of Professional Services
- Services for a customer and a fee
- Personal, Advertising and Bodily Injury exclusions



Cyber Insurance Market Place and Coverage

Available Coverages



Exposure Category		Description
Network Security Liability		Provides liability coverage if an Insured's Computer System fails to prevent a Security Breach or a Privacy Breach
Privacy Liability		Provides liability coverage if an Insured fails to protect electronic or non-electronic information in their care custody and control
Media Liability		Covers the Insured for Intellectual Property and Personal Injury perils the result from an error or omission in content (coverage for Patent and Trade Secrets are generally not provided)
Regulatory Liability		Coverage for lawsuits or investigations by Federal, State, or Foreign regulators relating to Privacy Laws
Crisis Management	Notification Expense	1st Party expenses to comply with Privacy Law notification requirements
	Credit Monitoring Expense	1st Party expenses to provide up to 12 months credit monitoring
	Public Relations	1st Party expenses to hire a Public Relations firm
Data Recovery		1st party expenses to recover data damaged on an Insured Computer System as a result of a Failure of Security
Business Interruption		1st party expenses for lost income from an interruption to an Insured Computer System as a result of a Failure of Security
Cyber Extortion		Payments made to a party threatening to attack an Insured's Computer System in order to avert a cyber attack
Professional Errors & Omission Liability		Miscellaneous E&O can be added to a policy when applicable

Network and Privacy Insurance

Privacy and Network Liability Market



- Primary up to \$20M+ Limit of Liability
- Capacity for individual risks can exceed \$200M
- Most Active Markets:

- ACE
- AxisPro
- Beazley (Lloyds)
- Chartis
- CNA
- Chubb
- Hartford
- Hiscox (Lloyds)

Premiums vary according to:

- Company revenues
- Industry group - Healthcare - Higher Risk
- Limits, sub-limits, retentions, terms & conditions
- Information management practices
- Standalone vs. packaged program (1st & 3rd party)



Thinking Ahead



- Risk Mitigation Efforts
 - Classification of Data
 - Effective Privacy Policy
 - Effective privacy breach response plan
 - Employee training
 - Regular testing of DRP and BCP
 - Review of you service provider's controls and policies



Data Breach Examples – Healthcare



- **ITRC20100329-02 Montefiore Medical Center NY 2/10/2010 - Published # 625**
- Type of Breach: Theft
- Location of Breached Information: Laptop
- Electronic
- Breach Type
- **Attribution 1** Publication: HHS Website Author: Date Published: 3/25/2010
- **<http://www.hhs.gov/ocr/privacy/hipaa/administrative/breachnotificationrule/postedbreaches.html>**

Data Breach Examples – Healthcare



- **ITRC20100311-05 Advanced NeuroSpinal Care CA 12/20/2009 - Published # 3,500**
- Advanced NeuroSpinal Care
- State: California
- Approx. # of Individuals Affected: 3,500
- Date of Breach: 12/30/09
- Type of Breach: Theft, Loss
- Location of Breached Information: Network Server, Desktop Computer
- Medical/Healthcare
- Electronic
- Breach Type
- **Attribution 1** Publication: HHS website Author: Date Published: 3/11/2010
- **<http://www.hhs.gov/ocr/privacy/hipaa/administrative/breachnotificationrule/postedbreaches.html>**

Data Breach Examples - Healthcare



- **ITRC20100225-02 University of Washington Medical Center, NCO**
WA - Published # 210
- KING 5 reported that the UW Medical Center learned a data breach involving SSN, credit card numbers, birthdates and addresses after King County sheriffs found the information inside the home of a convicted felon who was being arrested for violating parole. The man's girlfriend works for NCO Financial Systems, a company the medical center uses to process patient payments.
- Update: Other companies may be compromised
- Medical/Healthcare
- Electronic
- Breach Type

Data Breach Examples - Healthcare



- **ITRC20100212-02 University of Texas Medical Branch – Galveston, TX**
- Published # **2,400**
- Confidential information about 1,200 UTMB patients may have been stolen last year. The University of Texas Medical Branch at Galveston mailed letters Tuesday to patients whose private information was accessed by an employee of MedAssets, a company hired to assist with billing third-party payers. Individual records included the patients' names, addresses, Social Security numbers, insurance information, medical facilities where services had been received and, for a small group, additional medical details.
Update: UTMB has just sent out an additional 1200 letters to patients.
- Medical/Healthcare
- Electronic
- Breach Type
- <http://www.chron.com/disp/story.mpl/hotstories/6905384.html>
- <http://www.chron.com/disp/story.mpl/health/6862401.html>

Data Breach Examples - Healthcare



- **ITRC20091123-04 - Health Net - 11/19/2009**
ElectronicMedical/Healthcare - Published #1,500,000
- **A hard drive with seven years of personal and medical information on about 1.5 million Health Net customers was lost six months ago and was first reported Wednesday. A portable, external hard drive with Social Security numbers and medical records “disappeared” and is still missing from the insurer’s Northeast headquarters in Shelton, a Health Net spokeswoman said Wednesday. The hard drive contains Social Security numbers, medical records and health information dating to 2002 for 1.5 million customers — past and present — in Arizona, Connecticut, New Jersey and New York, the spokeswoman said. State AG's are very upset – which will result in Litigation**
- **Notification to each affected individual**
- **Continuing investigation**

Reasons to Consider Cyber Insurance



- Privacy Breaches are on the rise
- Network threats and vulnerabilities are getting dramatically worse
- State (Federal) Privacy Laws in response to frequency of Privacy Breaches
- Stakeholders demand prudent Risk Management that protects the organization
- Plaintiffs' bar is becoming more active
- Contracts are beginning to requiring Cyber Insurance
- Additional safety net if security defenses and procedures fail
- Rogue Employees, social engineering, hacker sophistication, and human error



“Many company networks are compromised... without them even knowing it.”

Thank You



Thank you for your interest in Arthur J. Gallagher & Co.

Joe DePaul

Area Senior Vice President
Management & Professional Liability

Arthur J. Gallagher Risk Management
Services

444 Madison Ave. 20th floor
New York, New York 10022-6947

Phone: 212-994-7054

Email: joe_depaul@ajg.com