INSURANCE IMPLICATIONS FOR MEDIA COMPANY MERGERS AND ACQUISITIONS

Media company mergers and acquisitions have increased dramatically during the past year as entertainment, media and communication industries strike deals to keep pace with consumer demand for content and bandwidth. According to a recent PricewaterhouseCoopers report, the monetary value of such deals has grown from $55 billion in 2011 to a staggering $96.2 billion in 2012.[1] Similar growth is projected in 2013.

The acquisition of content and distribution is not without risk. In addition to the usual business, legal and financial risks, there are unique exposures associated with the acquisition of media companies that disseminate their own content or that of a third party. Copyright infringement, in particular, is a significant media risk if the entity being acquired ("seller" or "target") employs a business model that relies upon cutting edge technology to gather or disseminate content. With respect to any acquisition where the target's liability are assumed, the acquiring entity ("buyer") must thoroughly assess the potential for latent liabilities and engage in robust risk management as part of its due diligence to identify, reduce and shift any such liability and to further minimize the risk post-acquisition. This due diligence may also affect the terms of the deal – especially if the buyer is unable to validate key assumptions about the target's business.

The due diligence team may include any number of attorneys, accountants, business consultants and investment bankers, all of whom participate in a systematic assessment of the target's business, including an evaluation of the target's exposure to legal liability. A review of all potentially implicated insurance policies – those of the buyer and the target - is a critical component of risk assessment, management and mitigation. Unfortunately, an often overlooked component is the role of the specialty media liability policy, which is less well known than standard insurance coverages. If the target and/or the buyer have adequate insurance in place for liability or loss that has been incurred, but not yet known at the time of the acquisition, exposure to both parties may be reduced.

A properly designed media liability or specialty errors and omissions policy is essential for any entity in the business of broadcasting, publishing, film and program production/distribution, music recording and publishing, advertising or related internet activities because of coverage gaps under the commercial general liability form. Additionally, media companies often provide services to third parties, thereby requiring specialty coverage for those ancillary services, as well as the content. Thorough due diligence can help the buyer better predict the availability and cost of this specialty insurance.

The identification of media content risks and any insurance coverage shortcomings should be thoroughly evaluated by the buyer up front, thus providing an opportunity to mitigate such exposures through a hold-back, claw-back or escrow contractual agreement with the target. The buyer may also

[1] *Available at* http://www.pwc.com/en_US/us/industry/entertainment-media/publications/emc-deal-insights.jhtml

want to consider the purchase of business transaction or Representations & Warranties insurance to better insulate itself from latent liabilities arising from the target's business. If the buyer self-insures for loss and related defense costs, proper identification and assessment of the target's contingencies allow for more accurate reserving.

M&A due diligence of media content liability is a two-step process. The first step is a thorough analysis of the target's operations and practices involving the creation or distribution of content, including advertising. The target's exposure to copyright infringement, should be carefully evaluated because there is potential for severity and latency with respect to this cause of action. An examination of the target's content includes the following analysis:

- Has an intellectual property audit been conducted of the target's own intellectual property and that licensed from others?

- Has the target's intellectual property been adequately protected under relevant state and federal laws?

- Is there a paper trial documenting compliance with respect to content licensed from third parties?

- Do contracts with independent contractors provide proper indemnities? Are the independent contractors required to have media liability or other specialty insurance?

- If the target is internet-based, has it complied with any take-down requests under the Digital Millennium Copyright Act? Has a registered agent been designated as required by this Act?

- If the target is a content creator, are there appropriate controls for the creation or clearance of the content?

- Does the target's intellectual property inventory include matter with a murky chain of title?

- Do the target's websites have latent liability issues arising from content, terms of use, online privacy agreements, the collection of personal identifiable information, and the use of material submitted by third parties? Does the target operate consistently with its terms of use and privacy policies?

- The target's use of social and professional networking must be closely reviewed. Are employees encouraged to post on networking sites or online forums on behalf of the target? The buyer should have access to all passwords for all social and professional network sites to review previous posts. Have any employees shared confidential information? Have there been any offensive postings about the target or third parties? Have any products or services of the target been falsely represented or advertised?

Step two of media acquisition due diligence involves the identification and examination of all relevant insurance policies, including the following analysis:

- Identify and review all relevant insurance policies of the buyer and seller. It is important to identify and understand the terms and conditions relating to the acquisition, merger or creation of new entities under the buyer's policies. Better policies will provide some automatic coverage.

- Identify the coverage triggers for the buyer's and seller's policies. Are the policies "claims-made" or "occurrence" policy forms? If any of the seller's policies are "claims-made," it is important to be familiar with all provisions and endorsements dealing with extended reporting period ("ERP") or "tail" coverage. This coverage provides for a designated time period after a claims-made policy has expired, during which a claim may be made and coverage triggered as if it had been made during the policy term. The event giving rise to the claim, however, must have taken place when the policy was in force.

- All insurance wordings, including endorsements, must be carefully reviewed. Are relevant definitions under the buyer's policies sufficiently broad enough to appropriately capture the seller's operations, employees and independent contractors, types of media content, assets and exposures?

- Post-acquisition, the buyer's insurers <u>will not</u> (absent unusual underwriting) cover any of the target's claims that arose from any known or foreseeable situation, event or conduct that took place pre-acquisition. Therefore, it is important that the target's insurers be placed on notice for all potential claims – especially if the policies require such claims to be noticed while the policies are in force or during any reporting periods. If the target does not have insurance in place, there should be a sufficient hold-back or Representations & Warranties insurance to cover such contingencies. Ideally, the acquired entity has an occurrence policy in place for media professional liability claims so that such coverage will apply regardless of when the claim is made – even if the entity has since been acquired.

- Are social media activities specifically addressed by the parties' media liability policies? Many policies do not cover social and professional networking sites absent a specific endorsement.

- Closely review any media claims in litigation and those of which the target is aware, but are not yet in suit. Are these claims covered by insurance? Have all insurers been notified? Are the liability limits adequate? Will the claim adversely impact the policy limits or aggregate available for future claims? Which entity is responsible for paying any outstanding self-insured retentions or deductibles post-acquisition? If any retention or deductible amounts paid by the target are later recovered through subrogation or other legal process, which entity is entitled to the recovery? What legal and loss reserves have been set by the insurer? The target should be required to obtain copies of loss runs from all insurers to try to discover loss and legal reserves, retention obligations, as well as amounts already paid.

- Carefully engage in insurance policy archaeology to ensure that the target has had media liability coverage in place for the entire period of time that it was engaged in the creation and/or distribution of content. If there are coverage gaps, can any existing policies be endorsed to provide coverage for prior acts?

- Following an acquisition, can the buyer make a claim under the acquired entity's prior policies? Should the prior policies be assigned to the buyer? Can they be assigned?

- Acquisitions must be added to the buyer's policies. All underwriters must be given sufficient time to underwrite the new exposures – especially if there is not automatic coverage under the policies for new acquisitions, as discussed previously. The buyer's insurance broker, risk manager and/or counsel must ensure that there are not any coverage gaps. If the target's media liability coverage was written on a claims-made policy and will be rolled over to the buyer's occurrence policy, there will be a gap in coverage unless proper endorsements are added to the policies of the buyer and/or the target to safeguard against such gaps. Because of the dormancy of potential copyright infringement claims, a three-year ERP is not unreasonable. Alternatively, the buyer's insurer may be willing to write a three-year prior acts period for any new media entities.

- Are the liability limits of any policies left in force post-acquisition adequate to cover the liabilities of the newly combined entity?

The above list merely scratches the surface of risk management due diligence when targeting a media company for acquisition. In addition to assembling a team of financial, IT and legal experts for due diligence purposes, it is also advisable to include experienced insurance professionals to assess relevant insurance policies, including the media liability policy, for the purpose of mitigating latent exposures and managing financial risk relating to known claims.

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