



# Skeletons In The Closet

**Mere hours before** his brokerage was about to change hands, through a competitor purchase, a brokerage manager noticed several irregularities. It was while he was finishing up some last-minute paperwork that he began glancing over some files. What he noticed were several odd items that he quickly classified as potential time bombs that could attract litigation against the brokerage in the future.

Worse, he realized that some of these irregularities had occurred under his watch, but with shifting priorities these matters had been relegated to the back burner. Despite the purchasing brokerage's due diligence process, these irregularities were somehow missed. Now, alone in his office, the manager paused to consider his best course of action:

- If I draw attention to these particular issues, for which I was previously responsible, it will not bode well for my future.
- It is only a few hours away from the transfer of ownership and this could jeopardize the sale. I have always looked out for the current owner's best interest and remain loyal to her.
- The purchaser had the opportunity to uncover these issues, thus they can share some of the responsibility if problems arise from them.
- We have been told that during the transition it would be "business as usual." Therefore under normal circumstances I would have brought the issues forward and dealt with them. Should I operate in that fashion today?
- Now what am I going to do? To whom should I be loyal and/or responsible?

In virtually every merger and acquisition transaction, the purchaser agreement or term sheet would include an indemnification agreement where the purchaser would have the right to claim for irregularities or misinformation. However, for a seller to rely on the principle of "buyer beware," especially when irregularities have come to light before closing, is to walk on very thin ice. The potential for litigation should always be averted as it is never the best course of action. Having been involved in a scenario where known information ought to have been disclosed and wasn't, it can make for very strained relations during the transfer of business, affecting not only the brokerage owners, but the insurer partners, staff and, even more importantly, the clients of both organizations. The fallout can be enormous and have a negative impact for years to come.

Lorie Guthrie Phair, principal at LePhair Associates Ltd., believes that the best course of action is full disclosure. This is usually the most appropriate course of action, particularly when the degree of irregularities is high. This is because the manager has

a professional responsibility and a fiduciary duty to disclose his findings to the brokerage owner and be accountable for the oversights. Further, rather than simply pointing out the oversights, he would be wise to take ownership of the problem, proactively outline the potential consequences and present some possible resolutions. This would be looking after the owner's best interests. Again, the consequences of not disclosing could be far greater for all parties involved. In turn, the brokerage owner has the obligation to disclose the new findings to the purchaser, along with the proposed solutions for consideration.

While there is always the risk of the deal going sideways depending on the financial impact of the irregularities, being forthright could go a long way to reinforcing a trusting relationship between the buyer and seller that will bode well during the transition of business, explains Phair. The sale of an owner-managed firm can be a very emotional transaction and, beyond a fair purchase price and acceptable terms, is often more about the people and the fit between the parties involved.

Neil Morrison, president and

CEO at HKMB Hub International, explains that his company has come across this and similar scenarios more than once and the right course of action can usually be found in a company's core values. At HKMB Hub, the company's Core Values are painted on six canvasses outside Morrison's office door, "for all to see every day."

As a result, Morrison explains that the conflicted brokerage manager risks facing two tough choices: being considered as incompetent or being considered a liar. Even if the issues did not arise during due diligence, representations and warranties still need to be made about what might be outstanding and problematic. The manager should also realize that it is a virtual certainty the irregularities will eventually surface and need to be dealt with, so he best take his medicine now, deal with the issues, and demonstrate that while mistakes might have been made, he assumes ownership of them and is working to resolve them, says Morrison. A good purchaser will see this as a positive test about the character of the manager and they will recognize that his institutional knowledge of the business is an important element of the goodwill they are purchasing. The manager will otherwise likely discover the alternative is not as bright in the not so long term.

Scenarios similar to this are, unfortunately, not that uncommon, says Bruce MacDonald, CEO, Mardon Group of Companies. With the purchase of many, or perhaps most, brokerages, there tend to be some "skeletons in the closet." A purchaser may not know if the skeletons will be in the form of unanticipated employee issues, a difficult corporate culture that needs changing, key clients that leave following the purchase, or a myriad of other challenging surprises that were not readily identifiable during the due diligence process. Even experienced purchasers know that they have to brace for such possibilities, which may be better classified as probabilities.

As a result, seasoned purchasers, or those with very astute lawyers and accountants, often fare better than relatively novice purchasers because they know from hard experience some key safeguards to insist upon. There are many intangibles that the due diligence process cannot reasonably be expected to uncover. The fact that something untoward has not been identified in that due diligence exercise should not absolve any parties from performing their ethical duties. ☒

The CIP Society represents more than 15,000 graduates of the Insurance Institute of Canada's Fellow Chartered Insurance Professional (FCIP) and Chartered Insurance Professional (CIP) Programs. This article is intended to generate a dialogue about ethics among professionals and we welcome comments and scenarios at [cips@insuranceinstitute.ca](mailto:cips@insuranceinstitute.ca). This series of articles is archived on The CIP Society's Web site at [www.insuranceinstitute.ca/cipsociety](http://www.insuranceinstitute.ca/cipsociety).

## IBAO Elects New President



**Peter Blodgett, CIP** was inducted as the 66th President of the Insurance Brokers Association of Ontario (IBAO) at the recent IBAO Convention held at The Fairmont Royal York Hotel in Toronto. Mr. Blodgett formally assumed his role as President on January 1, 2009.

A graduate of George Brown College with a diploma in Business Administration in Insurance, Peter began his career in 1981 with a direct writer and soon after joined his father at Darling Insurance in Peterborough, Ontario. The following year, Peter and his wife, Cindy purchased McAllister Insurance in Bobcaygeon.

Eventually, Peter returned to Peterborough to partner with his father at Darling Insurance. In 1997, Peter purchased Darling Insurance and is now the sole owner of the brokerage that has served the people of Peterborough for 80 years. Darling Insurance employs over 50 staff and has locations in Peterborough, Omeme and Bobcaygeon. Recently, Peter opened a new brokerage, Beyond Insurance, in Whitby.

Community involvement is at the heart of all brokers, and Peter is very involved with many charitable organizations in the Peterborough area. In the past 11 years, Peter has helped local organizations raise over \$1 million. Peter is particularly proud of the "Three Loonies on the Street" radio show that he and two friends have been putting on for the past 7 years during Christmas. This event alone has raised over \$250,000 for the local food bank.

Peter has served as the President of the Lindsay Brokers Association and the Peterborough Brokers Association.

Peter achieved his Chartered Insurance Professional (CIP) designation in 1987 and has served as a Territory Director for IBAO. During his tenure, he served as Chair of the Education Committee, Convention Committee and the Property Casualty Committee. He continued to serve on the Education Committee and in 2005 served as the Second Vice President on IBAO's Executive Committee.

In his spare time, Peter enjoys playing golf, baseball and hockey. He is also known to friends and family as a very capable chef and wine connoisseur. Peter and Cindy are also active members of St. Luke's Anglican Church in Peterborough.

*The Insurance Brokers Association of Ontario (IBAO) is a 'not for profit' association that represents and serves the interests of over 10,000 independent Property & Casualty Insurance Brokers in the Province of Ontario.*

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