

Buy the Business Buy the Mod

Question: I am thinking about buying an existing business and would like to know if there is anything I should consider about the workers' compensation insurance costs and claims experience of the prior owner before pursuing the business and negotiating a purchase price?

Answer: Buying a business is a very complex process. A buyer needs to understand the value of the business' assets, liabilities, goodwill and growth potential as well as many other factors. One factor that is often overlooked is the workers compensation loss experience of the previous owner.

Why does that matter? Because in Oregon when you buy a business that is large enough to qualify for an experience modification, you are also buying that owner's experience modification. (Generally, an annual premium of \$2,500 or more is enough to qualify for an experience modification) Put simply, when you buy a business there is no clean slate and you inherit the experience modification of the prior owner.

Typically buying a business means that you are buying the business name, equipment, client list, vehicles, buildings and staff. Not much changes, at least not immediately, when you flip a switch and the business has a new owner. So the conditions that existed to create the experience modification whether good or bad will exist when the new owner takes over. The Oregon rules for experience rating dictate that in cases of businesses changing hands that the new owner's workers compensation policy will continue to carry the experience modification of the prior owner.

Our Office has dealt employers who unknowingly purchased a business without checking on the experience modification of the old owner. In these cases, the new owners have been surprised by a very high experience modification that has negatively impacted the business' financial status. In one case, this has also resulted in litigation for lack of disclosure and conflict of interest. This is not a problem that a brand new owner of a business wants to deal with when taking over a new enterprise.

How much money are we talking about? This will vary with the size and experience of the business, however if the claims experience of the prior owner was dramatically worse than what would be expected of other businesses of similar size and nature, one could expect costs to increase 50% or more over the average cost. To compound matters, if the owner is unable to secure workers compensation insurance in the voluntary market than the assigned risk plan becomes the only option as a market of last resort. The assigned risk plan has the highest rates and also applies an additional factor over and above the experience modification depending upon the loss experience of the business. This is called the Supplemental Assigned Risk Adjustment Plan or SARAP. This additional factor can decrease costs by 5% if the business has excellent loss experience, but it also can increase costs by as much as 49% if claims experience is very poor. Think of the hardship of having an unanticipated increase of costs of almost 50% by not examining the loss experience of the prior owner.

Besides the impact of the experience modification and SARAP on workers compensation insurance costs, other indirect costs to consider is the possibility of an accident prone or litigious work force or unsafe workplace conditions that may result in additional capital investment or staff changes by the new owner.

Our Office also recommends that a prospective business buyer request a copy of the latest loss reports for the current year and prior year. If the loss experience for these two years have been worse than average, future experience modifications will be adversely impacted for at least three years into the future. Our office has the available tools to help project future estimated experience modifications should this situation arise.

Much like buying a used car, a prospective buyer of a business needs to check under the hood before making an offer. A car may look brand new on the outside, but an expensive repair could be lurking if you don't look closer. Checking the experience modification and loss experience is one of those pesky "under the hood" details. By checking into the loss experience of the former owner, you may avoid a nasty surprise, or at the very least be able to more accurately estimate the value of a business before making an offer.