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GRAHAM ADVISOR

NOTES
FROM THE PLAYBOOK

The manufacturing sector has always faced a very complex set of risk management challenges and this fact has never been truer than it is today. The latest National Association of Manufacturers quarterly survey revealed only slightly more than half of manufacturers are either "somewhat" or "very positive" about their company's outlook. According to the survey, two of the biggest challenges facing manufacturers are rising health care/insurance costs and attracting and retaining a quality workforce.

It's for this reason we've dedicated this issue of Graham Advisor to discussing best practices for mitigating some of the risks associated with these challenges. In the pages of this issue, we discuss the hidden risks in acquisitions, how to prevent injury-related claims as the next generation enters the workforce and how businesses can avoid getting hit with the looming tax on their health care plans.

The manufacturing industry is faced with enough challenges as it is. We believe that effectively managing risk requires a proactive approach. We can help your business avoid and reduce the risks that may leave it exposed though regular risk analysis, a tailor-fit insurance program, workforce education and aggressive claims management.

I encourage you to read this issue to get a better understanding of our experience in this sector. To learn more about how we can help your company, please contact me or the authors at feedback@grahamco.com.

KENNETH L. EWELL
President & COO

M&A Insurance Due Diligence Considerations

Merger and acquisition (M&A) activity in the industrial manufacturing space is heating up. After a difficult stretch for the last several years, many companies are finally in a position to seek strategic opportunities for growth. One such opportunity is to grow by acquisition.

Assembling value, a quarterly analysis conducted by PwC on global deal activity in industrial manufacturing, showed M&A activity remains robust and is being driven by smaller deals. The PwC analysis revealed the overall number of M&A deal volume increased by 10 percent – well above the 10-year historical average. The volume of deals in this sector is expected to increase at a similar pace in 2016 as it did in 2015 because lower company valuations within the sector are attracting both strategic and financial buyers.

While acquisitions are a strategic way to expand and grow a business, companies need to be aware of the potential challenges that M&A presents. Typically, companies have internal personnel, legal counselors, investment bankers and certified public accountants around the table to perform due diligence, leaving a very critical seat at the table empty. The role of an insurance broker should not be underestimated. An insurance broker can review insurance coverage, examine contractual risk transfer and analyze loss history for red flags.

There could be a multitude of issues that could be uncovered during the process, including problematic open claims, product liability issues, coverage gaps and deficiencies and unknown pollution liabilities. It is for these reasons it's necessary for an acquirer to perform a careful, high-quality due diligence process to protect itself from the risks of an M&A transaction. Once the risks have been identified, it is important for the acquirer to effectively negotiate transaction terms through which the risks between the acquirer and the seller are properly allocated.

Asset Purchase vs. Stock Purchase

The most common type of M&A transactions in middle-market manufacturing are structured as asset purchase agreements. Unlike a stock purchase, where the company is buying the seller's stock and all of its assets and liabilities, an asset purchase deal allows the buyer to choose the assets they are buying. This involves the purchase of the selling company's assets, including facilities, equipment and inventory. An asset purchase sale also provides the buyer with protection by being able to choose which, if any, of the seller's liabilities it will assume. Most buyers' strategies are to take on little or none of the sellers' liabilities. The reality is that sometimes that's not always feasible.

The asset purchase agreement outlines the terms and conditions agreed upon by the buyer and seller. It will spell out exactly which assets and which liabilities the buyer is assuming.

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ASK THE EXPERT

Alan Mar on best practices for training new workers in the manufacturing industry

Q. A new generation of workers will be entering the workforce as veterans prepare to retire. How can companies make sure knowledge of and adherence to safety guidelines are not lost during the transition, leading to injury-related claims?

A. A company's Standard Operating Procedures (SOPs) are a great place to start. Through SOPs, you can develop a Job Safety Analysis (JSA), Job Hazard Analysis (JHA) or Job Task Analysis (JTA) based on your exposures. The purpose of the JSA, JHA or JTA is to break down each step of the job task and identify ways to eliminate and mitigate the probability of an incident by way of OSHA's hierarchy of controls. These JSAs, JHAs and JTAs are written work procedures that serve as teaching aids and outline how to perform a job safely. The written procedures should be posted throughout the workplace to serve as reminders to new employees about potential hazards and best practices for performing the job safely.

Q. What is ANSI/ASSE Z490.1 Standard and how does it apply to training employees?

A. The American National Standards Institute (ANSI) and American Society of Safety Engineers (ASSE) recently published the revised industry standard ANSI/ASSE Z490.1 that applies to a broad range of training programs and specifies how to adequately design, develop, deliver and evaluate training employees. There are several ways an organization may use Z490.1. Industry employers may use it to assess external training providers or to audit or improve internal corporate training programs. Training providers may use the standard to assess and improve their training services and last but not least, corporations may use the standard as a basis for developing and managing training programs. While governmental regulations specify mandatory requirements for employee training, Z490.1 industry standard is recommended for all companies to follow because it provides additional guidance in developing safety protocols for employee training.

Q. What are some other examples of effective ways to train employees to prevent injuries?

A. Job-shadowing and "Stretch-and-Flex" programs are two techniques that have proven to be very effective. Job shadowing allows a new employee to become familiar with a job by observing a trained and experienced employee over a period of time, ranging from one week to six months, depending on the job. A Stretch-and-Flex program is implemented by the employer and requires workers who perform manual material-handling tasks to conduct a series of stretching exercises prior to commencing work.

Q. What else can employers do to make sure employees remain safe?

A. In addition to training employees, employers should conduct periodic inspections of the workplace to confirm equipment is properly guarded and installed correctly and that the environment is conducive to employee needs to perform their jobs safely.

If you would like to learn more about employee training programs, contact Alan Mar, CSP, CDS, CESCP, ARM, Senior Safety Consultant at The Graham Company, amar@grahamco.com or 215.701.5316.

GRAHAM SIGHTINGS

Experts in the News

Rafael Haciski on preventing risks associated with resident-owned and -operated surveillance cameras
Long-Term Living, May Issue

Micah Knapp on contractual risk transfer
University Business, July Issue

Jim Marquet and Mark Troxell on the hidden risks in a rebounding economy
CFMA Building Profits, September/October Issue

Awards & Recognitions

The Graham Company Named No. 2 Top Workplace for 2016
The Philadelphia Inquirer has consistently ranked The Graham Company as a top workplace in the Greater Philadelphia area in the midsize company category for seven consecutive years.

Join the Conversation

Follow us on Twitter @TheGrahamCo and we'll deliver daily insight to keep your employees safe and your business thriving.

For all the details on the latest insurance trends and how your business can benefit, follow our "Risk Matters Blog" at grahamco.com/KnowledgeCenter/Blog

BENEFITS BRIEF

Cadillac Tax Impact on Employer-Sponsored Health Plans

When the Affordable Care Act was enacted in 2010, it included a new 40 percent excise tax on high-cost employer-sponsored health plans as a means to constrain health care costs. Nicknamed after the luxury car, the Cadillac tax is expected to greatly affect workers as employers scale back on benefits and drive up the employees' share of health costs to avoid the tax.

How Does the Cadillac Tax Work?

The Cadillac tax, which Congress recently delayed from 2018 to 2020, will impose a levy on expensive health plans above specified thresholds – plans whose value is more than $10,200 for individual coverage and $27,500 for a family. While the Cadillac tax was designed to hit "high-value" health plans, it will spread to other plans. This is primarily because the annual increases in the tax thresholds are based on the consumer price index. However, medical inflation is greater than consumer inflation. Because the Cadillac tax is connected to consumer inflation, it creates a system where the tax will not truly adjust for inflation and medical premiums will break through the threshold causing employers to pay the tax.

The Cadillac Tax and Employee Benefits

The impact of the tax on manufacturers' health plans will be substantial. Many manufacturers use high-value health plans as an important part of employee compensation. Companies have already started reducing health benefits so they don't hit the threshold that triggers the tax. According to a report by the National Association of Manufacturers, under a medium-growth scenario (6 percent) the tax would hit between almost 30 percent of manufacturers' plans by 2025 and more than 80 percent by 2035.

If you are interested in learning more about how the Cadillac tax affects your health plan, contact Jason Edelman, Producer – Employee Benefits Consultant, The Graham Company at jedelman@grahamco.com or 215.701.5326.

Depending on how the asset purchase is written and what jurisdiction they are in, there are situations where a buyer can still unknowingly pick up a seller's liability.

Consideration No. 1: Product Liabilities

The most significant liability risk for a buyer in the manufacturing industry is successor product liability. This means the buyer can be faced with liability suits for products already manufactured and in use. Product liabilities typically result from defective products, personal injury claims or warranty breaches. When performing due diligence, buyers will review the company's existing and past product offerings. Ideally, they can exclude these liabilities in the asset purchase agreement. If for any reason the liabilities can't be excluded, the buyer should still be aware of them.

Preventing the financial effects of future product liability claims requires a thorough review of the seller's current insurance coverage. When reviewing the policy, the buyer needs to determine whether the company has adequate insurance that will protect their business from potential product liability claims. While a general liability policy will provide coverage for product claims, it will only pay for the damage or harm the product caused. It does not pay the costs to repair or recall the product. Therefore, buyers should consider purchasing product recall insurance as a way to mitigate a potential product recall.

Depending on how the asset purchase is written and what jurisdiction they are in, there are situations where a buyer can still unknowingly pick up a seller's liability.

Consideration No. 2: Contractual Risk Transfer

The due diligence process also entails examination of indemnity clauses within the contracts the seller has signed. Every contract a company signs contains some level of risk transfer. "Indemnity" is the obligation placed on another party through a contractual relationship. Some contracts are one-sided and all of the risk transfers to the party with the least amount of leverage, while others are more balanced and attempt to assign liability directly on to the responsible party. It is critical for the buyer to make sure their insurance policies will comply with any contractual agreements in which they are required to partake.

Consideration No. 3: Loss History

Examining the Property & Casualty Insurance loss history of a potential acquisition is a very important part of the due diligence process. A manufacturer with severe product liability losses could be a red flag for a buyer and could even prevent them from making the acquisition. A review of the loss history can also uncover problematic trends in workers' compensation claims. It may allow the buyer to re-engineer their manufacturing process to prevent excess lifting and material handling, thus reducing common and repetitive injuries. A buyer also wants to make sure it is well-aware of employees who have a history of workers' compensation or automobile claims.

Consideration No. 4: Transaction-Related Insurance

During the process of due diligence, a buyer may also have to purchase additional transaction-related insurance depending on the terms of the purchase agreement. This could include site-specific Pollution Legal Liability Insurance, and Representations and Warranties Insurance.

In larger acquisitions, both sellers and buyers may benefit from purchasing Representations and Warranties Insurance. This coverage is triggered by allegations of a breach of a warranty or representation made in the purchase or sale agreement. Commonly, these representations involve declarations about the company's assets and liabilities in its financial statements and representations regarding pending litigation, intellectual property and environmental issues found within the agreement. While the policy is designed to provide financial protection for the seller, the buyer also benefits because they have the security of an insurance policy to respond if the allegations have merit.

Any time real estate is included in a purchase, Pollution Legal Liability (PLL) Insurance should be carefully considered. Unknowingly, a buyer could purchase real estate that has pre-existing pollution conditions, such as seepage of contaminants into the soil or a body of water. A PLL policy can be written to provide liability coverage for new and pre-existing conditions. In addition to third-party coverage, these policies can also provide first-party coverage for the on-site clean up of pollutants. When making a purchase of real estate (especially for older manufacturing plants), a buyer would be wise to consider performing a Environmental Site Assessment, which can identify potential environmental contamination liabilities.

As M&A activity continues to remain healthy in the manufacturing sector, more companies will look to acquisitions as a growth strategy. Before any transaction is complete, it's crucial companies first consult with their insurance broker, who can assist in performing a careful and comprehensive due diligence assessment.

To learn more, please contact Luke Foley, Producer, at The Graham Company at lfoley@grahamco.com or 215.701.5332.

EXECUTIVE ANNOUNCEMENTS

EXECUTIVE HEALTHCARE RISK FORUM

OCT. 6-7

STOCKTON SEAVIEW HOTEL

Galloway, New Jersey

The Graham Company's Health & Human Services Division is bringing together health care industry leaders for an Executive Healthcare Risk Forum. The day and a half forum is an exclusive opportunity for executives to participate in an intimate, think tank-style event where they can exchange ideas and best practices with their peers.

The forum will consist of moderated sessions with panelists discussing the most pressing operational and financial challenges facing the healthcare industry today. These topics include legal trends, employment and labor issues, cyber and privacy liability concerns, the regulatory environment and changing reimbursement structures.

The forum will culminate with an address by *Richard P. Miller,* President and CEO of *Virtua Health System*, about taking and overcoming risks in the health care industry.

To learn more and register for the forum, please visit
www.grahamco.com/events.php

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