



COMMERCIAL INSURANCE

EMPLOYEE BENEFITS

PERSONAL INSURANCE

RISK MANAGEMENT

SURETY



ADVANCED MANUFACTURING

RISK in Focus



Background

Developing and implementing risk management strategies is a critical function for leaders of Advanced Manufacturing enterprises. Nearly all the risks these companies face can be placed along a sliding scale at a unique point between the polar extremes of “controllable” vs. “noncontrollable.” To make it more challenging, the scale consistently slides based on macro and microeconomics, supply chain challenges and ever-evolving technology evolution.

Business owners and leadership teams may view most day-to-day risks as relatively controllable. Potential incidents that can occur within the walls of the plant are top of mind for them – equipment fires and worker injuries, for example. The related risk control strategies developed will be related to equipment maintenance and worker training, and therefore are likely to be incorporated into daily operating procedures and job requirements.

However, consideration of uncontrollable risks is imperative from an Enterprise Risk Management perspective. It’s important to note that the term “noncontrollable” refers to the event or occurrence, not its impact. For example, a direct hit on an advanced manufacturing facility by an F3 tornado can’t be controlled or avoided, however, maintaining employee evacuation strategies and obtaining adequate Property & Casualty Insurance and Business Interruption Loss Insurance can minimize employee injuries and help ensure the continuation of the company.

In this paper, we’ll explore three significant risks faced by advanced manufacturing companies – risks that lie at various spots along the controllable/noncontrollable spectrum:

- + Recovery from major destructive incidents
- + Patent infringement
- + Merger and acquisition (M&A) complications

In each case, and for dozens of other risks that aren’t apparent on a day-to-day basis, advanced manufacturing companies should develop strategies to manage and mitigate these risks in order to maintain the value of their assets and maximize their P&L.

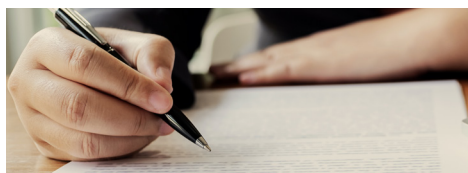


4



**Recovery from Major
Destructive Incidents**

6



Patent Infringement

8



**Merger & Acquisition
(M&A) Complications**





Recovery from Major Destructive Incidents

NON-CONTROLLABLE

SOMEWHAT CONTROLLABLE

MOSTLY CONTROLLABLE

CONTROLLABLE



Hazard 1:
Recovery from Major Destructive Incidents

Operations at an advanced manufacturing facility can be brought to an extended and catastrophic halt due to major events like acts of nature, fires, internal flooding, specialized equipment failure and more.

Owners should have contingency or business continuity plans in place for these situations that describe how the company will shift operations to another model or to another location on short notice.

If a relocation is required and or feasible, the leadership team should be systematically identifying and tracking the lease rates at nearby sites that have the critical infrastructure to support the company's operations. Legal teams should be prepared and trained to review these kinds of leases on short notice.

Advanced Manufacturing firms utilize unique and expensive equipment, in which it is not practical to purchase and store replacement equipment to maintain ideal business continuity preparedness levels. Understanding the creation and distribution of inventory levels and delivery times requires maintaining relationships with worldwide equipment providers on a primary, secondary and tertiary basis.

Maintaining Business Interruption Loss Insurance is another important element of a business continuity strategy; this coverage is known as revenue protection in the event of a covered property or cyber event that damages critical manufacturing infrastructure. Business owners should maintain detailed financial records documenting the impact of the interruption, including revenue, payrolls and extra expenses incurred post-event.





Patent Infringement

NON-CONTROLLABLE



SOMEWHAT
CONTROLLABLE



MOSTLY
CONTROLLABLE



CONTROLLABLE



Hazard 2:
Patent Infringement

Innovation is the hallmark of Advanced Manufacturing. Innovative equipment, processes and other intellectual property (IP) are core to a company's value and a key to future growth prospects.

Manufacturing firms maintain a variety of IP and trade secrets in the form of formulas, plans, patterns, processes, programs, tools, techniques, mechanisms, compounds or devices – things that are not generally known or readily discoverable by competitors or others. Enterprise Risk Management for manufacturing firms should include the following:

STEPS FOR PROTECTING A COMPANY FROM CHARGES OF PATENT INFRINGEMENT

1. Performing due diligence within the industry to identify possible areas of overlap in IP-based products and processes.
2. Hiring a well-qualified attorney/firm that specializes in technology IP.
3. Vetting all vendor and supplier contracts to ensure the company is indemnified from any IP infringement cases related to the use of the vendor's product.
4. Bespoke employee training that includes the risk of intellectual property theft and how it can be protected.



These steps alone can't insulate an advanced manufacturer from allegations of infringement by competitors or, more commonly, spurious charges of infringement by patent trolls. In these cases, defenses can be costly, including legal fees, settlements, and loss of revenue due to possible cease and desist orders.

Average Patent Litigation Cost:

\$2.8-3.6M

where damages are between \$1-25M

The **American Intellectual Property Law Association** (AIPLA) estimates that the average cost of patent litigation cases in the U.S. is between \$2.8 and \$3.6 million for cases where damages are between \$1 million and \$25 million. Those average costs escalate to over \$6 million when the damages claimed exceed \$25 million.

Insurance coverage for Intellectual Property is highly complex. Abbreviated and partial coverages can be found in some General Liability and Media Liability coverages, but as each policy and each portfolio differs drastically, it is imperative to engage with a knowledgeable broker that can not only ascertain a firm's IP exposure but provide risk management counsel and identify how IP risks can affect other policies, such as Directors & Officers Liability.





Merger & Acquisition (M&A) Complications

NON-CONTROLLABLE

SOMEWHAT CONTROLLABLE

MOSTLY CONTROLLABLE

CONTROLLABLE



Hazard 3:

Merger & Acquisition (M&A) Complications

Organizational changes, including Mergers and Acquisitions can be articulated as risk that is largely controllable if addressed proactively. Many times, insurance and risk management are afterthoughts, following an enterprise's otherwise lengthy due diligence process, audits, financial reviews and legal negotiations. However, engaging an insurance brokerage firm early in the process can alleviate stress by providing assistance with both due diligence and enterprise risk management. Common concerns or deal points such as indemnification for supply chain issues, tort liability and contract management can be assessed and insured via traditional insurance policies.

An M&A process can be lengthy and complex, allowing plenty of room for complications which may lead to claims alleging breaches of representations and warranties (R&W) for undisclosed conditions such as price increases; inventory and supply chain issues; and environmental, social and corporate governance (ESG) disputes. R&W challenges are common at this time, given declining economic markets, political activism and turbulent geopolitical global conditions.

To protect the parties, R&W Insurance (RWI) is available for both the seller (protecting them from liability) and the buyer (providing first-party coverage to compensate them for alleged breaches by the seller). Both parties should be aware however that RWI policies do not provide coverage for breaches relating to disclosed or known issues.

In general, the insurance implications of M&A deals tend to be an afterthought by the buyer. This can be a costly mistake. The company is not only buying a ledger of assets and liabilities but also taking on other less quantifiable and possibly unknown liabilities. The buyer's insurance exposure could be dramatically affected by the seller's product lines, facilities, customers, locations, reputation, employees and more. A qualified insurance broker can help uncover these issues.



The buyer's insurance broker should be an active participant in the due diligence process from the start, researching a myriad of documents including the seller's current insurance policies, endorsements, claims reports, Workers Comp claims, contracts and leases, financial information, audits and third-party cybersecurity assessments. Based on this information, the broker can advise the buyer on how to cap liability, whether R&W Insurance would be prudent and which policies survive and which can be terminated. The broker can also determine the ideal portfolio of insurance products for the merged company, along with pricing estimates to support the decision-making process.

M&A activity generates a material change in exposure, which often comes with a reporting requirement to incumbent insurance carriers.

Again, your broker should provide guidance on Change in Control Provisions and necessary midterm adjustments. If a claim arises, and there was a failure to communicate with carriers, coverage could be denied on the basis of misrepresentation of risk/exposure.

Working with a broker who understands the nuances of M&A transactions can significantly bolster due diligence efforts and mitigate substantial risk for all parties involved. When working with the acquiring entity, IMA performs a comprehensive analysis on the seller's insurance portfolio. Key areas of focus include, but are not limited to; coverage, cost, structure, claims history, loss ratio, concurrency and consistency amongst coverage periods (especially claims made), contractual liabilities/obligations, quality control and existing risk management practices.





MORE THAN JUST INSURANCE

Based in North America, Parker, Smith & Feek is an integrated financial services company focused on protecting the assets of its widely varied client base through insurance, risk management and wealth management solutions. As an employee-owned company, PS&F's 1,800-plus associates are empowered to provide customized solutions for their clients' unique needs.



RISK IN FOCUS CONTRIBUTORS

ALEX FULLERTON, *Marketing Specialist, Marketing Intelligence & Insight*

BRIAN LEUGS, *Writer*

DANIEL POSNICK, *Transactional Liability Leader, Executive Risk Solutions*

RENEE STOCK, *Vice President, Senior Advisor and Consultant: Advanced Industries Specialty*

MARK WARE, *Executive Vice President and National Practice Director, Advanced Industries Specialty*

This material is for general information only and should not be considered as a substitute for legal, medical, tax and/or actuarial advice. Contact the appropriate professional counsel for such matters. These materials are not exhaustive and are subject to possible changes in applicable laws, rules, and regulations and their interpretations.

NPN 1316541 | IMA, Inc dba IMA Insurance Services | California Lic #0H64724
©IMA Financial Group, Inc. 2023 | CT-RIF-PSF-AM-020123

www.psfinc.com