

Food Safety The Changing Landscape of Product Recall

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Product recall, are two words no food manufacturer or processor wants to see next to their name. But the food industry is one of the most exposed industries to a product recall. A food industry product recall can be caused for a variety of reasons including, mislabeling or not correctly labeling the ingredients (the most common cause), accidental contamination, or malicious tampering. What are the risks associated with a product recall to the many food processors and manufacturers across the country? How can these risks be managed?

What is at stake? Risks and Exposures

Federal initiatives and Legislation directed at food safety has increased public awareness and increase the responsibility of food manufacturers and processors to appropriately respond, and indeed survive in the event of a recall. Regardless of whether it is a national recall of peanut products, or a local or regional recall of specific lot numbers of a processed food, product recall has costly consequences for food manufacturers and processors. These consequences can be categorized into two different types of risks, first party and third party. Both of these risks can have short and long term costs associated with them.

A first party risk or exposure is one that is incurred directly by the food processor or manufacturer who must recall a product. Initial costs associated with a recall can be significant, but

there are also long term costs critical to a manufacturers' successful recovery following a recall. Out of pocket expenses necessary to implement and successfully survive a product recall can include:

Initial recall expense:

- Employee overtime
- Media, communication
- Product testing, destruction and disposal
- Public relations, crises management or consulting fees

Replacement costs:

- Materials, labor and overhead directly related to reproducing product that had to be recalled and or destroyed.

Lost Profits

- Profits lost as a result of products recalled
- Future profits lost as a result of declined sales

Brand Rehabilitation

- Consumer education and advertising
- Promotional or price reduction campaigns

Product recall presents a third party exposure, that to a certain extent, is out of the control of the typical food manufacturer or processor. Third party exposures are losses incurred by a customer of a food manufacturer or processor, as a result of a recall caused by the food manufacturer or processor. These losses can include the customer's recall expenses, lost profits, extra expenses and even losses affecting other products sold by the

customer. The recall of any food ingredient will affect the finished food product, and potentially all of the processors involved.

How to manage the risk

Food processors and manufacturers have a unique exposure to product recall because of the potential harm their products can cause. Key to managing this risk is understanding what is, and is not covered under typical general liability policies. Essential to successfully surviving a product recall is a risk management plan. A well designed risk management plan will include risk transfer techniques and crisis management. Risk transfer is purchasing an insurance policy to cover the costs associated with a recall. Crisis management involves the internal planning and training to quickly mitigate losses and recover.

Risk Transfer

The cost of a product recall could be hundreds of thousands if not millions of dollars. Few food processors or manufacturers could survive a financial catastrophe of this nature. One of the best and most affordable risk transfer techniques is to purchase Product Recall or Contamination and Malicious Tampering insurance.

There are however major differences among the policies offered by the various insurance companies, what events can trigger coverage and what is covered. In an attempt to meet the growing demand and specific needs

of food processors and manufacturers, insurance companies have recently expanded and enhanced policies to offer broader coverage.

Product Recall vs. Products Liability

A common misconception is that Product Recall is included in a standard ISO Commercial General Liability policy. While the standard ISO Commercial General Liability policy does provide coverage for bodily injury caused by the insured's products, the policy excludes coverage for product recalls. The ISO Commercial General Liability policy excludes "damages claimed for any loss, cost or expense incurred by you or others for loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of your product, or your impaired property."

Product Contamination and Malicious Tampering Policy vs. Product Recall

Products Contamination and Malicious Tampering insurance is also known as an Accidental Contamination and Malicious Tampering Policy. This type of policy is normally targeted towards food and beverage manufacturers distributors and retailers. The primary purpose of a Products Contamination policy is to provide a variety of critical first party coverages addressing the expenses an insured might be forced to incur should a product be contaminated or tampered. The incurred expenses must be the result of a covered product being maliciously tampered with or the result of an accidental contamination. The policy coverage is normally triggered by an actual or suspected accidental contamination or malicious tampering, that has the potential to cause or has caused bodily injury or property damage. Most insurance companies who provide Product Contamination Insurance include coverage for: Product Recall Expenses

(first and third party); Product Replacement; Extra Expenses; Loss of Profits; Product Rehabilitation Expenses; and Fees or Expenses of a Specialist or Consultant.

Most Product Contamination and Malicious Tampering policies are broken into three main sections. Section I addresses Malicious Product Tampering. Section II addresses Accidental Product Contamination. Section III is normally a General Terms and Conditions section that applies to both Section I and Section II. Each policy section should clearly define covered recall expenses as well as excluded events or expenses.

Product Recall insurance policies are different from Product Contamination policies in two major ways. Primarily, the Product Recall policy is triggered by the recall or withdrawal from the market place of a product. This recall can be due to a defective or malfunctioning product that has the potential or already has caused bodily injury or property damage. Coverage under a Product Recall policy is not triggered by the contamination of a product. It is important to also note that under a Product Recall policy products still in the insured possession, housed at the insured's location, and not shipped yet, would not be covered, as the product has not been recalled. Secondly, Product Recall policies limit the first party losses to recall expenses and the repair, replacement or refund of the product. Normally the basic Product Recall policy does not provide coverage for any first party loss of profits or extra expenses. For these reasons it is best, whenever possible, to place a Food Processor or Manufacturer on a Products Contamination and Malicious Tampering form

Crisis Management Plan for your Insured

A critical factor to successfully managing the risk of a product recall is a crisis management plan. This plan should be formally documented and practiced, and include provisions that will allow the immediate identification and recovery of contaminated or tampered products. The plan should also include communication strategies to notify vendors, distributors, retailers and customers. A crisis management team should be created, consisting of critical employees and management, and outside consultants. Many insurance companies that offer Product Recall or Product Contamination and Malicious Tampering policies also provide crisis management assistance often through an outside specialist.

Closing

Engaged American consumers and the current political climate factored together with the passage of the FDA Food Safety Modernization Act means food manufacturers and processors need to be aware of their risks, and risks to their customers in the event of a product recall. There is much that a food processor or manufacturer can do to manage these risks, both internally and externally. A company's commitment to quality including utilizing suppliers who share that same commitment is a critical component to a successful risk management plan. Risk transfer through insurance, which should include crisis management assistance, will transfer the risks which cannot be financially absorbed by a food processor or manufacturer. A well designed product recall risk management plan can mean the difference between a food processor and manufacturer surviving a product recall.