

ADDRESSING RECALL RISKS IN THE FOOD SUPPLY CHAIN



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Product Recall

The food supply chain is a complex network that involves various stages, from sourcing ingredients to delivering the final product to consumers. However, this intricate process also poses risks, as all ingredients have a risk element that needs to be addressed. In order to ensure the safety of the food supply chain, it is crucial for companies to implement effective approaches to control and mitigate these hazards, as accidents do happen.

Approaches to controlling supply chain hazards

Controlling supply chain hazards involves a combination of measures, including supplier verification procedures and evolving risk-based preventive controls. Regardless of whether the ingredients are imported or sourced domestically, it is essential for companies to have documented evidence that risks are tracked, categorized, food safety measures are in place, and these measures are verified and validated.

For companies using imported ingredients, the Food and Drug Administration (FDA) requires the implementation of a Foreign Supplier Verification Program (FSVP). However, it is important to note that many companies have mistakenly believed that the importer of record (i.e., middleman) is responsible for reviewing the exporter's food safety plan. In reality, it is the responsibility of the company using the imported ingredient to have their own food safety plan, along with evidence of third-party audits and other supporting documentation.

One common practice in the food supply chain is the use of a Certificate of Analysis (COA) to verify the safety of ingredients. However, it is crucial to conduct risk-based, laboratory verification of COAs, as these documents are not always accurate despite best efforts.

Managing supply chain hazards also involves analyzing the size, scope, and cost of potential recalls. While the cost of periodic verification of laboratory COAs may seem burdensome, it is a necessary and worthwhile investment. Holding ingredients until they are verified to meet all hazard requirements can ultimately save companies from the financial and reputational costs and damages associated with recalls.

Broker considerations

Ensuring that your broker has bone fide Product recall insurance expertise is crucial in navigating the complexities of different policies and their specific language and intent. Failure to fully understand these policies can result in companies incurring problematic claims or facing unexpected coverage disputes. Crucial issues to consider to ensure your program operates smoothly during a crisis include, but are not limited to:

- Your broker has a thorough understanding of your company, products, or operations to secure a properly designed policy (structure, form, endorsements, manuscript language, etc.).
- Wholesaler broker involvement generally means you will lack top-level support from a claims advocacy perspective.
- Follow proper procedures for retaining, reporting, and cooperating during a recall event.
- Lack of access or relationships with insurers who can offer the proper (or generally competitive) coverage.
- Avoidance of insurers with poor intent not clearly outlined in their policy wording.
- Expert claim support and resources, as insurers are not responsible for guiding policyholders to payment.

By addressing these areas and ensuring recall expertise is utilized, companies can minimize the risk coverage disputes, better protecting their financial stability and reputation.

GENERAL LIABILITY EXCLUSION (ISO FORM) — SECTION I.2.N. (COVERAGES — EXCLUSIONS):

- Damages claimed for **any loss, cost, or expense incurred by you or others** for the **loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal, or disposal of:**
 - » (1) “Your product;”
 - » (2) “Your work;” or
 - » (3) “Impaired property;”
- If such product, work, or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy, or dangerous condition in it.

It's critical to understand the realities of the intent of general liability coverage (and this specific exclusion) relative to recall-related incidents. This intent changes depending on your operations. Understanding this is imperative. This means that selling final products vs ingredients/components are treated differently by a GL policy. And if you are a contract manufacturer or a “co-packer,” the GL policy will provide even less protection.

Product contamination and recall coverage: understanding key areas of loss

Product contamination (recall) coverage can vary depending on the specific products, operations, and negotiated coverages. In the event of an accidental product contamination, malicious tampering, or government recall, whether caused by your company or a component supplier/manufacturer on your behalf, significant losses can arise in the following key areas:

- **Recall and replacement costs:** This includes expenses related to testing, logistics, destruction, and replacement of the affected products.
- **Business interruption:** Concerns over product safety can lead to a decline in consumer and/or customer confidence (or plant suspension) and a subsequent decrease in sales, resulting in business interruption losses.

- **Brand rehabilitation expenses:** Rebuilding trust and restoring the reputation of your brand can incur significant costs.
- **Crisis consulting:** Engaging crisis management consultants to navigate the challenges and mitigate the impact of the incident.
- **Third-party consequential damages:** Your commercial customers who used the product you produced on their behalf or your ingredient to make their final product may suffer financial and operational losses.

These areas of loss can be recovered under a product contamination policy if your product is the cause of a covered incident. It is important to carefully review and understand the terms and conditions of your policy to ensure that you have appropriate coverage in place to protect against these potential losses.

Supplier arrangements

When establishing supplier arrangements, it is crucial to carefully consider the contractual rights and obligations that can impact insurance recovery. Taking a cross-disciplinary approach is essential to avoid the negative consequences of a fragmented or disjointed approach.

Key considerations for supplier arrangements include:

- **Contract/PO terms and conditions or handshake:**
 - Co-Man, Co-Packer, or Tolling arrangement
 - Continuing guaranty
 - Battle of the forms
 - Privity of contract — use of brokers; impact of Economic Loss Doctrine on recovery
- **Allocating product recall/contamination liability between you and your suppliers:**
 - Reps and warranties
 - Indemnification/defense obligations
 - Express liability for recall expenses and financial losses
 - Limitations or caps on liability or damages
 - Insurance requirements: Additional insured status and subrogation waivers (as applicable)
 - Access to records, the right to audit supplier facilities, and protocols
 - Control over recall decisions, public communications
 - Governing law, venue, force majeure
 - Be mindful of jurisdiction-specific laws

By carefully considering and negotiating these terms, companies can establish robust supplier arrangements that not only protect their interests but also facilitate insurance recovery in the event of a recall or contamination incident, leaving them in a more favorable position for future renewals. It is important to engage legal, risk management, and insurance professionals to ensure a comprehensive and cohesive approach to supplier agreements.

Pursuing subrogation in food losses

When it comes to recall and contamination claims in the food industry, the focus is often on the finished product. However, subrogation efforts target the upstream product/ingredient suppliers, which can include farms, packagers, warehouses, co-packers, distributors, and other entities involved in the supply chain. Various types of claims can arise in these situations, including:

- **Foodborne illnesses** caused by pathogens such as Listeria, Hepatitis, E.coli, Salmonella, and others.
- **Physical contaminants** like glass, plastic, stone, metals, bone, and other foreign objects.
- **Spoilage issues** related to food preservation.
- **Allergen-related incidents** involving common allergens such as wheat, soy, fish, milk, nuts, eggs, crustaceans, and more.

By identifying the responsible parties and pursuing subrogation in these food losses, companies can seek compensation for their losses and hold the appropriate entities accountable for their role in the incident. This not only helps recover financial losses but also promotes a safer and more reliable food supply chain.

33M

Americans have food allergies.

51%

of adults and **42%** of children with food allergies have experienced a severe reaction.

More than

170

foods have been reported to cause allergic reactions.

Each year in the US, an estimated **3.4 million** patients visit the emergency room because of their food allergy.

Source: "Facts and Statistics: Key information to help better understand food allergies and anaphylaxis," FARE.



Pursuing ingredient suppliers

When pursuing ingredient suppliers in the event of a recall or contamination claim, there are several potential factors to consider:

Pros

- **Business relationship:** Having an established business relationship with the ingredient supplier can facilitate communication and cooperation during the recovery process.
- **Clear liability:** In cases where the liability of the ingredient supplier is evident, it becomes easier to pursue them financially for the incident.
- **Adequate insurance:** It is beneficial if the ingredient supplier has sufficient insurance coverage to provide financial compensation for the losses incurred; however, it may lead to a more involved process for all parties involved.
- **Contractual obligations:** If there are contractual agreements in place that include indemnification clauses, the ingredient supplier may be contractually obligated to cover the losses, making for a more simplified process.

Cons

- **Proving liability:** One challenge in pursuing ingredient suppliers is the need to provide sufficient evidence to establish their liability in the incident.
- **Business relationship:** In some cases, a strong business relationship with the ingredient supplier may create complexities or conflicts of interest during the recovery process.
- **Inadequate insurance:** If the ingredient supplier does not have adequate insurance coverage, it may limit the potential for financial recovery.
- **Contractual impediments:** Contractual provisions such as limitation of liability, limitation of damages, or subrogation waivers can create obstacles in pursuing ingredient suppliers for compensation.
- **Jurisdiction/foreign suppliers:** Dealing with jurisdictional issues or suppliers located in foreign countries can add complexity to the pursuit of ingredient suppliers.
- **Arbitration clauses:** If arbitration clauses are present in the contractual agreements, it may impact the process and venue for resolving disputes.

By carefully considering these pros and cons, companies can make informed decisions and develop effective strategies when pursuing ingredient suppliers for recovery in recall or contamination incidents.

In conclusion, addressing recall risks in the food supply chain requires a comprehensive approach to hazards, proactive measures to control them, and strategic approaches to managing incidents. For more information and expert guidance on addressing recall risks in the food supply chain, we encourage you to contact our team of experts, who can provide tailored advice and support.



About the authors



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Bill Harrison started his insurance career with an underwriting position at AIG. He worked his way up from a regional underwriter to a global position in their special services division, which handled several products, including malicious product tampering. During this period, Bill rewrote the policy to include accidental contamination and other broadening aspects of the coverage to create the coverage we know today. Bill was involved with underwriting, marketing, and reinsurance of the division's products. As managing director, he was responsible for the quality of the team's work, growth, and profitability of this business. In addition to co-authoring a book — The Executive's Desk Book on Corporate Risks and Response for Homeland Security — he spent 10 years improving the products, expanding the specialty insurance market, and helping hundreds of companies address their crisis management risks. This included a high-profile crisis management and security partnership to offer high-level security and crisis consulting work to corporate America called the Aon Giuliani Protocol, which resulted in a profitable group with brokers/consultants in 24 countries. Bill also started a large and successful product recall/contamination brokerage practice with Marsh. Bill joined Gallagher in 2018 and is now focused on helping clients manage their product recall and product contamination risk.



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Adam's responsibilities include oversight and management of Gallagher's Product Recall practice, including market placement and policy customization for accounts ranging from middle-market to Fortune 500 companies. Adam began his career at RT Specialty Chicago, where he was a Casualty and Product Recall broker. After four years, he moved over to Marsh to run the Midwest for their Product Recall practice and co-lead the practice's Food & Beverage Center of Excellence prior to departing for Gallagher in 2018. He brings years of expertise and policy placement strategies in the following industries: Food & Beverage, Automotive, Electronic Components, Finished/Consumer Goods, Whitegoods, Pharmaceuticals and Nutraceuticals, Medical Devices, Restaurants, Supermarkets, Distribution/Logistics, Chemicals and Ingredients, Aviation Components, and more creative solutions outside the general scope and appetite of the Product Recall market. His past and current responsibilities include market placement, policy customization, coverage advisement, claims advocacy, contract review/feedback, crisis mitigation support, market relations, and more. Here at Gallagher, he looks to leverage his expertise to help create additional best-in-class services, wordings, and products, which include but are not limited to Gallagher-exclusive coverage enhancements, platforms, whitepapers, etc.



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Steve Kluting, Esq., Gallagher's National Director of Product Recall (Food & Agribusiness practice), is an experienced corporate attorney and food industry executive focused exclusively on advising clients in the food and beverage industry. Using his experience as a "food lawyer," certified HACCP manager and industry executive, he acts as a risk consultant to Gallagher's food and grocery clients, helping them better assess and manage their product contamination and recall exposure; navigate food safety incidents, government enforcement actions, and product recalls; evaluate, design, negotiate, and place product contamination/product recall insurance; and report to corporate boards regarding company food safety risks. Steve spent more than 13 years as a member of a large, full-service law firm, many as a partner and co-chair of the firm's food industry practice. He focused on serving FDA- and USDA-regulated companies, advising them on the impact of food laws and regulations, crisis preparation and management, M&A, and risk management. More recently, he worked as chief strategy officer for a family-owned food wholesaler and retailer. Steve joined Gallagher in 2014 and is 100% dedicated to advising our food industry clients on their food safety risks.



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