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TOPIC 5: LIABILITY WITHIN FOOD SAFETY LAWS/FOREIGN SUPPLIERS

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Outline

- Liability and Food
- Product Recalls
- Foodborne Outbreaks
- Types of Recalls
- Product Recall/ Contamination Insurance
- Recall Underwriting Process
- Recall Costs
- The Recall Insurance Market
- Mechanics of a Claim

Liability and Food

Each year in the US, roughly **one in six individuals** becomes sick as a result of foodborne illness, and thousands are hospitalized or die.

In the US, a person injured as a result of a foodborne illness may bring a **civil cause of action** against another by claiming the other individual is **legally liable** for the harm caused by the foodborne illness.

Liability

- Legal doctrine under which a party is legally accountable for an illness or injury.

Product Liability

- Legal doctrine under which a party that is in the business of selling or distributing products, and who sells or distributes a defective product, is subject to liability for harm to an injured person caused by the defect.

Strict Liability

- Legal doctrine under which a party is responsible, without proof or fault, for injuries caused by the products he or she manufactured, distributed, or sold.

What is Civil Liability?

Civil liability determines an individual's or an entity's responsibility for harm caused by an illness or injury. The civil liability system provides injured parties with an opportunity to seek compensation for a loss or injury. A civil claim is called a "tort."

The injured party (the "plaintiff") must prove the liable party (the "defendant") had a legal responsibility to protect him or her from harm (otherwise known as a "duty of care.")

The plaintiff) has to show the defendant failed to protect him or her, and as a result the plaintiff was injured in a way that was foreseeable

The standards for holding someone liable differ depending on what and who caused the injury. The obligation a party owes to protect another party depends on the situation.

What is Product Liability?

The theory of "product liability" provides an injured person a cause of action (a reason to bring a lawsuit) against the source of the product to seek a monetary remedy for that injury. Product liability is how the law determines whether a party should be held liable for a harm caused by a defective product.

Three Elements of a Product Liability Claim

Product Liability and Food

As applied to unsafe food, food is the "product," and food suppliers, manufacturers, processors, distributors, and others that are part of the food chain may be held liable if an individual becomes ill or injured by a food that was either unsafe ("defective") or if the quality of the food was misrepresented.

A product can be defective if the instructions or warning are proven to have been inadequate to protect the user or consumer. A food product may also be defective if it contains certain pathogens (especially if a pathogen is considered to be an adulterant in that type of food).

Strict Liability

Strict liability is a legal concept that stands for the idea that: "One who sells any product in a defective condition unreasonably dangerous to the user or consumer…is subject to liability for physical harm thereby caused," with liability applying even if "the seller has exercised all possible care in the preparation and sale of his product[.]"

In plain terms, strict liability basically means that someone can be held liable even if he or she did not cause the problem leading to the injury.

Theory	Description	Example
Manufacturing defects	Food (or food product) is in a defective condition if an ordinary consumer would not reasonably expect the food to contain the substance that caused the harm	A jar of peanut butter contains *salmonella*
Design defects	A product has a design defect if it was manufactured in a way that fit the manufacturer's designs, but the design itself was not reasonably safe and the cause of injury	A recipe for potato chips contains a dangerous chemical
Failure to provide an adequate warning or instructions	A product lacks an adequate warning if a manufacturer or seller failed to provide warnings of product dangers or instructions on how to safely use their product	A seller fails to include a warning label on oranges that states the dye applied to the skin of the oranges contains a well-known allergen

Prevalence and Costs of Product Recalls

On average, nearly **30 product recalls occur every week in the US**; nearly 22 per week occur on average in Europe. Yet, many food and beverage companies are uninsured or underinsured for product contamination or mislabeling, the most common triggers for a recall.

Product recalls are expensive and occur frequently

For large companies that had faced a recall in the previous five years, 77% of respondents to a 2011 Grocery Manufacturers Association (GMA) poll estimated the financial impact to be up to $30 million USD; 23% reported even higher costs.

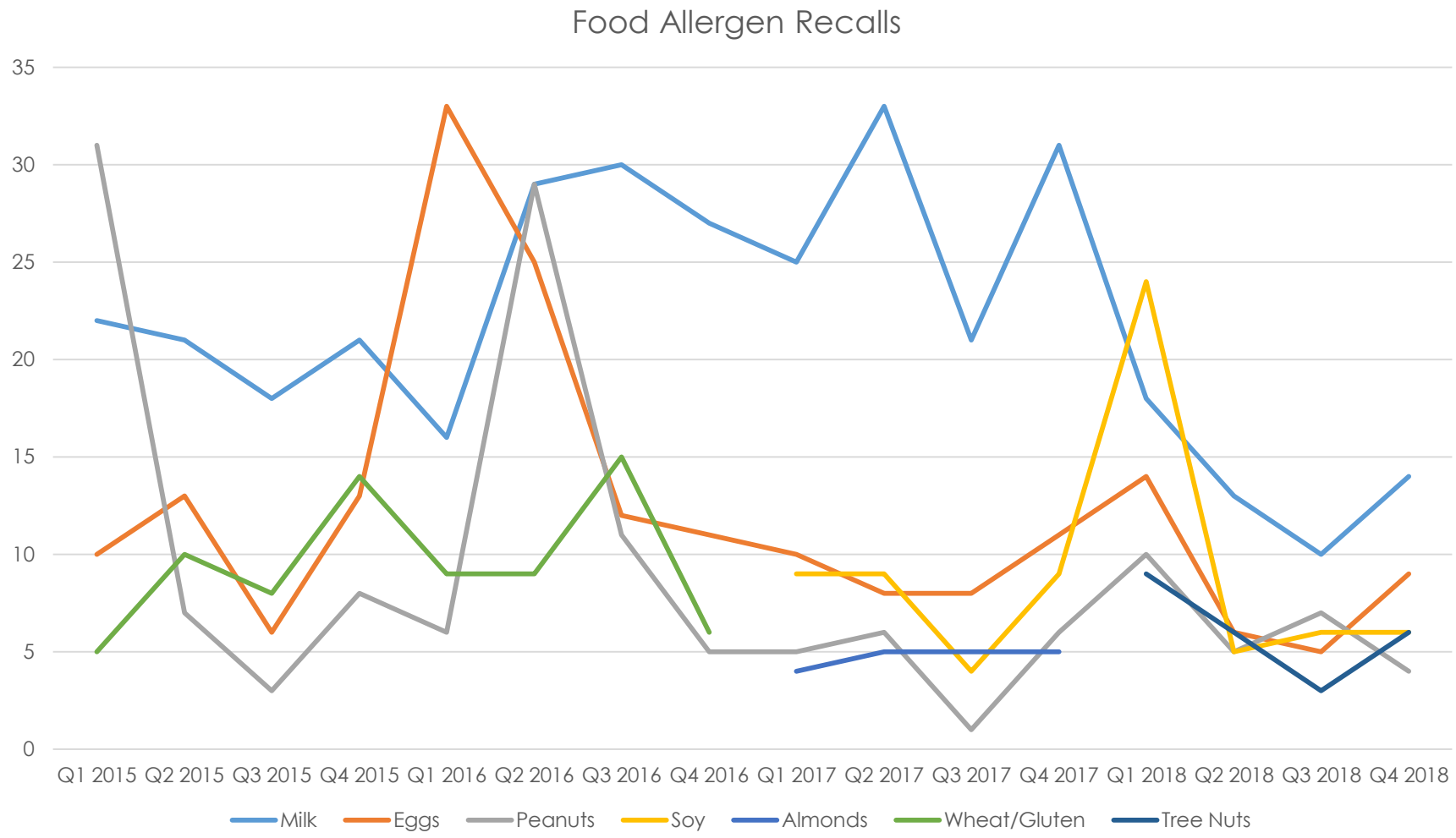
Regulatory oversight is increasing

Legislation such as the FSMA from 2011 in the US and the REGULATION (EC) No 178 from 2002 in Europe expands the government mandate in the food safety area. The FDA, USDA and European Food Safety Authority (EFSA) closely monitor product contamination and have the mandate to enforce corrective action ranging from product recall to suspension of production at affected plants.

Global supply chains are increasingly complex

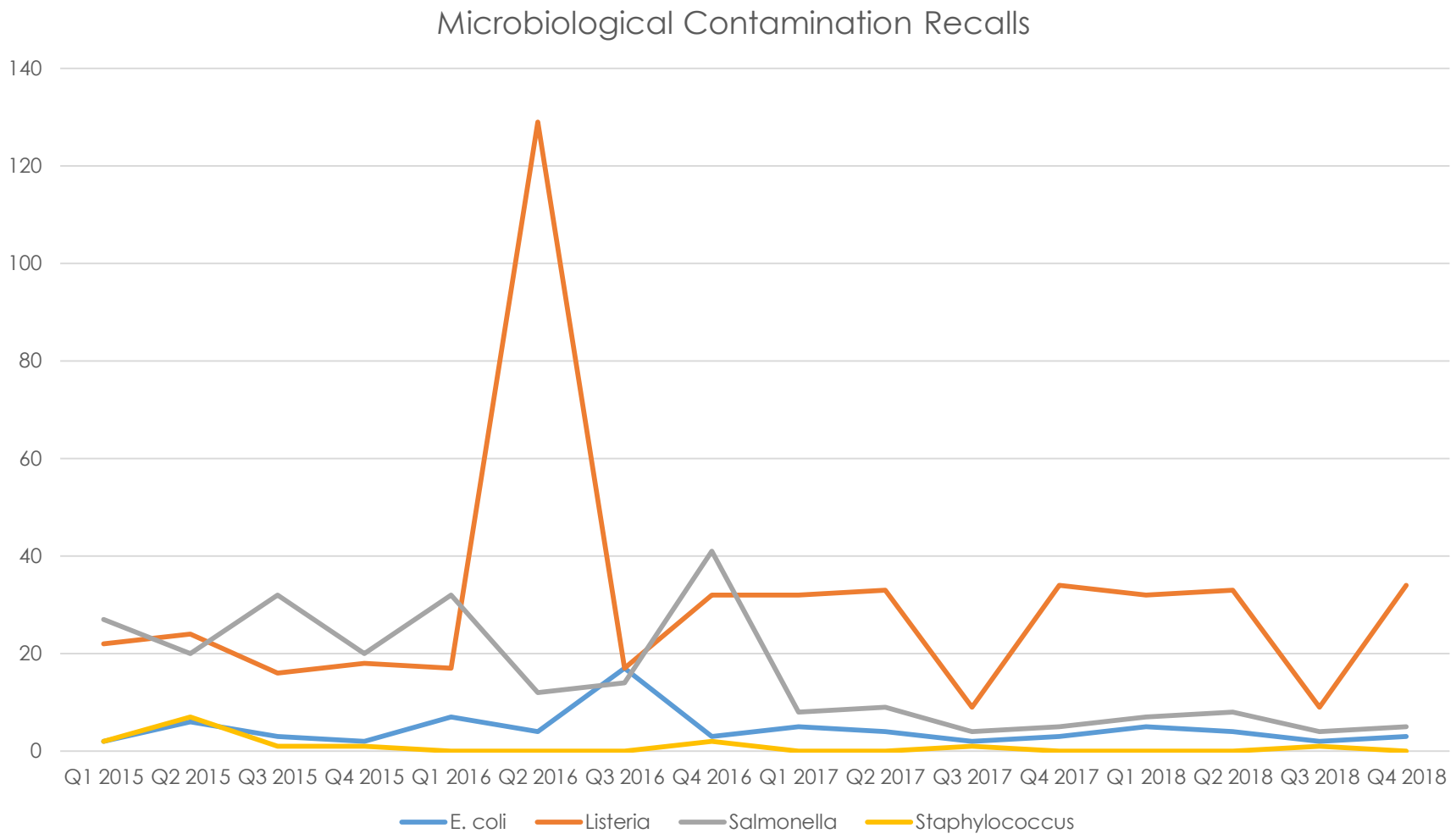
Food imports to the United States have grown by an average of 10% each year over the last seven years, according to the FDA. In Europe, from calendar year 2000 to 2012, EU agricultural imports increased from an estimated $53.3 billion to more than $131 billion.

US Food Recalls, 2015-2017



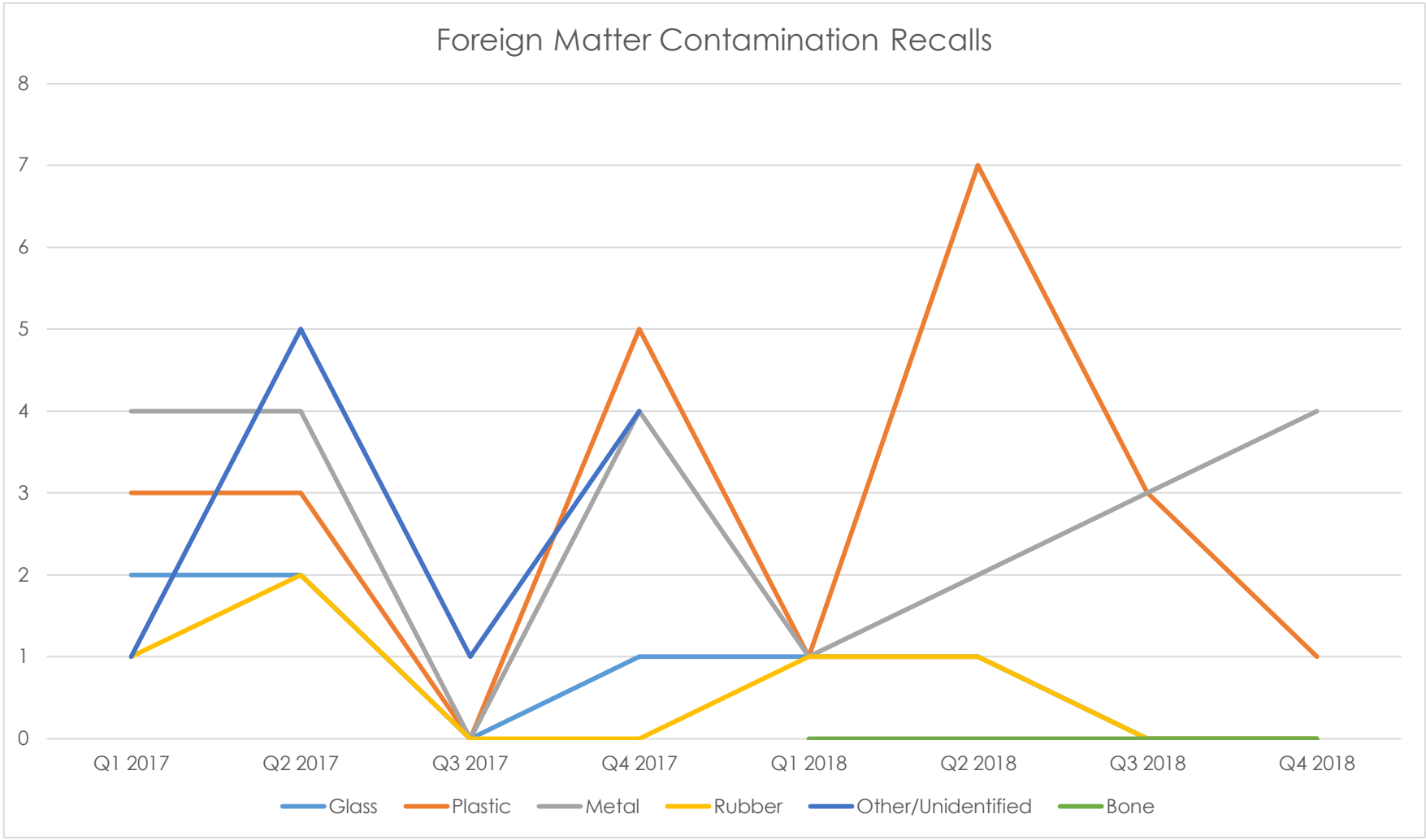
Source: Food Safety Magazine

US Food Recalls, 2015-2017



Source: Food Safety Magazine

US Food Recalls, Foreign Matter, 2017

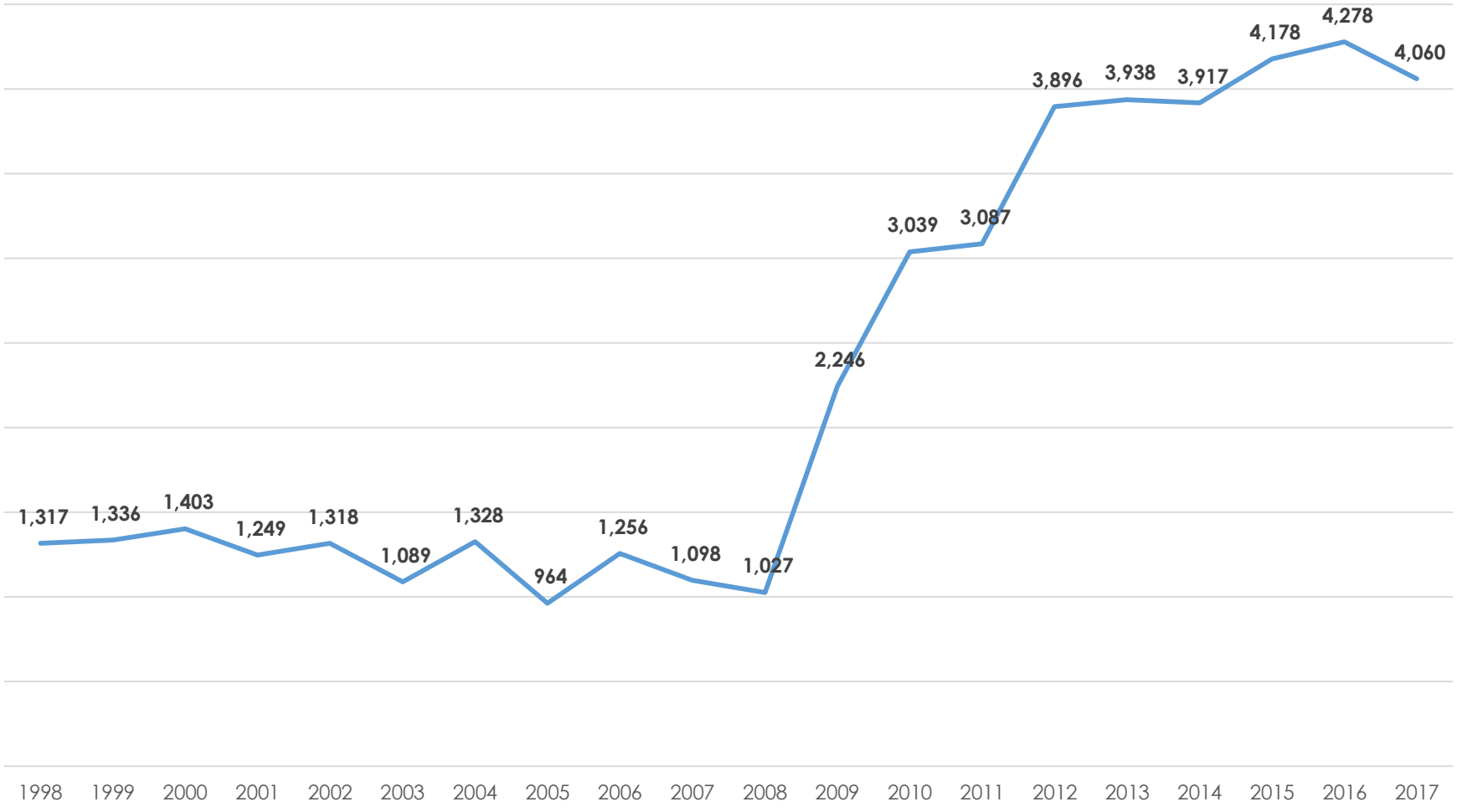


Source: Food Safety Magazine

Factors Contributing To Acceleration In Recalls

- Technological advances enhance detection
- Global supply chains (lower degree of familiarity regarding manufacturing practices, quality, etc.)
- More science-based regulatory compliance efforts
- Evolving legal environments
- Real-time worldwide communications raise awareness of defects, challenge reputation management
- Enhanced risk management practices target improved QA and proactivity on recall issues

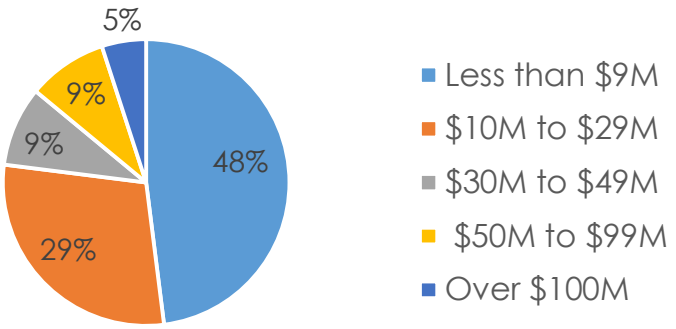
Foodborne Outbreaks: Breaking Records!



Source: CDC National Outbreak Reporting System (NORS)

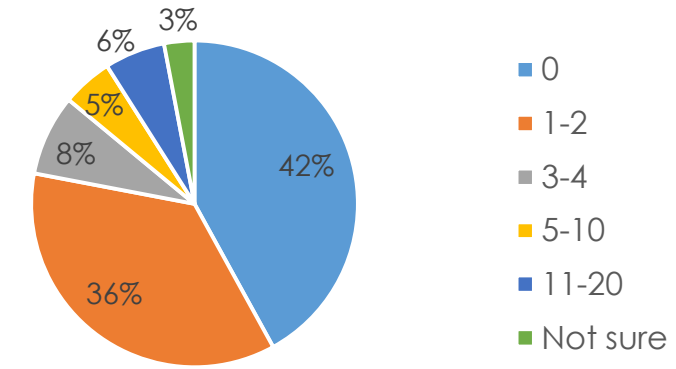
Some Statistics

Estimated financial impact (sales losses, direct recall costs, etc.) as a result of a recall



Source: *Capturing Recall Costs*, 2011 report by the GMA, Covington & Burling and Ernst & Young

Number of health/safety recalls in the previous five years

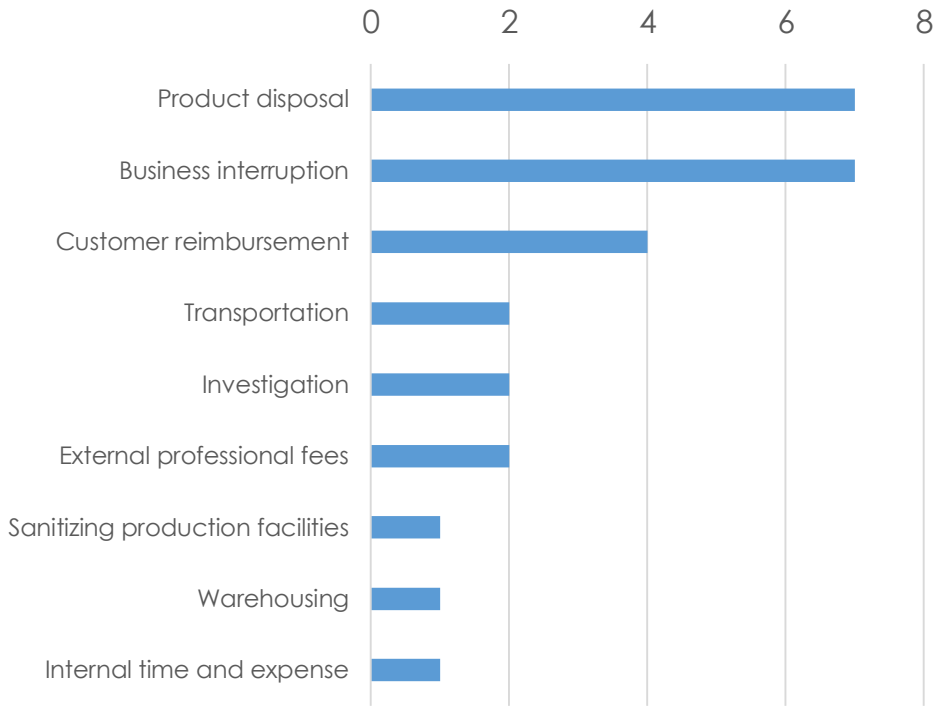


Source: *Capturing Recall Costs*, 2011 report by the GMA, Covington & Burling and Ernst & Young

Issues that typically drive recall costs:

1. **Health and safety**
2. **Severity and scope**
3. **Frequency**

Costs captured (number of respondents)



Source: *Capturing Recall Costs*, 2011 report by the GMA, Covington & Burling and Ernst & Young

Recalls: Voluntary vs. Involuntary

Voluntary

- Describes majority of product recalls
- Company elects to pull product from the stream of commerce because of a safety issue
- Given potential fines and other consequences, never truly "voluntary"

Involuntary

- Government regulators compel a company to conduct a recall

In either case, ***government oversight drives the decision***

Recall Classifications

Class I

- Reasonable probability use of or exposure to a product will cause **serious adverse health consequences or death** (e.g., E. coli contamination)

Class II

- Use of or exposure to a product may cause **temporary or medically reversible adverse health consequence**s or where the probability of serious adverse health consequences is remote (e.g., bacterial infiltration of Staphylococcus adequate to cause food poisoning)

Class III

- Use of or exposure to a product is **not likely to cause adverse health consequences** (e.g., contamination related to aesthetic qualities such as off taste or color, and/or mislabeling)

Product Recall/Contamination Insurance

Types Of Coverage
- Accidental Contamination
- Malicious Tampering
- Mislabeling
- Product Extortion
- First and Third Party Recall
- Food Borne Illness

Covered Losses
- Pre-Recall Costs
- Product Recall Costs
- Increased Cost of Working
- Product Rehabilitation Expense
- Loss of Gross Income
- Retained Consultants
- Incident Response Expense

Representative Classes
- Meat & Poultry
- Seafood
- Dairy
- Fruits & Vegetables
- Beverages/Bottler
- Prepared Foods
- Baked Goods
- Non-Food Consumer Products
- Ingredient/Component Parts
- Pharmaceuticals
- Restaurants/Food Service

Pricing Considerations
- Scope and quality of written recall plan
- Scope of product distribution
- Sales network
- Diversity of product lines
- Product Recall loss experience

A Tale of Two Classes

Attractive

- Meat & Poultry
- Seafood
- Dairy
- Fruits & Vegetables
- Beverages/Bottler
- Prepared Foods
- Baked Goods
- Non-Food Consumer Products
- Ingredient/Component Parts
- Pharmaceuticals
- Restaurants/Food Service

Restricted

- Nutraceuticals (incl. dietary supplements)
- Pharmaceuticals
- Ingredients
- Products sold/distributed in bulk or as commodities
- Animal feed
- Pet food
- E-Cigarettes

"Flavors" of Product Recall Insurance

Covered Costs	Product Recall (Withdrawal) Expense	"True" Product Recall and Contamination
Notification	■	■
Stationary, production of announcements	■	■
Overtime paid to regular non-salaried employees and expenses incurred by employees, including transportation and accommodations	■	■
Transportation, shipping and packaging	■	■
Warehouse or storage space	■	■
Advertising and promotions		■
Shipping to collect recalled products		■
Fees to wholesalers, distributors and retailers		■
Business interruption		■
Reputation repair and management		■
Value of contaminated products		■
Crisis response and consulting, including public relations and recall consultants		■

What Underwriters Want To See

- Application form
- Copy of Recall and Traceability Program
- Copy of Quality Control Manual (incl. Standard Operating Procedures/ Sanitation Standard Operating Procedures and Good Manufacturing Practices)
- Five-year loss history

Drilling Down on Costs

PRODUCT CONTAMINATION EXPENSES

PROPERTY DAMAGE

Condemned Product — value of the contaminated product that must be recalled and/or destroyed.

Product Recall — expenses incurred to trace, identify and withdraw contaminated product from the stream of commerce.

Product Destruction — depending on the type of product, extent of distribution and nature of contamination, destruction costs can be expensive.

Recall Consultants — companies may employ recall or crisis management consultants to access specific skill sets, minimize disruption of the business and contain brand damage.

THIRD PARTY

Property Damage — typically applies if the contaminated product becomes an ingredient of another product.

Bodily Injury — liability resulting from the bodily injury caused by the contaminated product to consumers.

BUSINESS INTERRUPTION

Product Unavailability — a product contamination may affect a large volume of stock leaving a company unable to meet demand.

Decontamination Downtime — decontamination of manufacturing equipment may result in partial or complete shutdown.

Government Intervention — government agencies may require closure of a plant until safe manufacturing conditions are restored.

Brand Damage — loss of sales, due to loss of contract or confdence in a product, following a contamination event.

"Collateral Damage": A Case Study of 2018 Romaine Advisories

Q2 2018 – April Romaine Advisory

- Q2 romaine sales fell roughly 13% in volume and value terms relative to what may have been expected without the advisory. (1)
- As romaine sales fell, other leafy greens were used as substitutes and their sales increased slightly (approximately 1%). (2)
- Pre-packaged sales fell, but not to the same extent as romaine, as other lettuce was substituted in mixes containing romaine and sales of other non-romaine mixes increased. (3)

Q4 2018 – November Romaine Advisory

- Q4 romaine sales fell roughly 23% in unit sales volume and 20% in value terms relative to what may have been expected without either advisory. (4)
- Data available to date does not fully answer the question: "How long does it take consumer demand to return after an advisory?" However, the data does show that retail romaine sales had not fully recovered from the April advisory when the November advisory hit (third quarter sales remained 3-5% below the 2018 baseline).
- As romaine sales fell, other lettuce was substituted and sales increased 10% by unit sales and 23% by value relative to seasonal trend expectations. (5)
- Pre-packaged salad sales decreased more than in Q2. Yet, this decline was not as steep as it was for romaine due to some degree of substitution within the mixes. (6)

	Year over Year		2018 Baseline	
	Unit	Value	Unit	Value
Spring 2018 Advisory (Q2 2018 vs. Q2 2017 & Q2 2018 Baseline)				
Romaine	-14%	-24%	(1) -13%	-13%
Leafy Greens Excluding Romaine	3%	2%	(2) 1%	1%
Other Lettuce	7%	3%	7%	10%
Spinach	5%	5%	5%	6%
Pre-Packaged Salads	1%	1%	(3) -1%	-1%
Fall 2018 Advisory (Q4 2018 vs. Q4 2017 & Q4 2018 Baseline)				
Romaine	-26%	-27%	(4) -23%	-20%
Leafy Greens Excluding Romaine	0%	1%	03%	-1%
Other Lettuce	10%	22%	(5) 10%	23%
Spinach	0%	6%	-4%	8%
Pre-Packaged Salads	-3%	-2%	(6) -6%	-5%

Source: Nielsen (data), CoBank (analysis & 2018 baselines)

Adding up the losses

The 2018 romaine advisories resulted in lost revenue at the retail level of $52M (est.). This excludes other costs (discarding the product, business interruption, investigation, transportation, etc.) or any costs from other parts of the supply chain. For example, many growers and shippers lost revenue, were forced to discard product, and had to disk under un-harvested crop.

Cost Drivers: Type of announcement | Specificity | Timing | Duration | Geography | Diversification | Consumer awareness | Size | Contracts

(Dumb) Arguments Against Purchasing Contaminated Product Insurance (CPI)

We Already Buy General Liability Insurance

CPI is a first party coverage and protects the insured from financial loss resulting from a product contamination incident. CPI does not require a third party lawsuit or other legal proceedings. CPI supports a proactive crisis management approach and may reduce third party exposures resulting from consumption or use of a contaminated product.

The Deductibles Are Too High

The deductibles are designed in relation to the daily company output so insurance is not triggered by minor (and frequent) manufacturing errors.

The Insurance Is Too Expensive

CPI provides affordable and predictable protection. It is designed to protect against events with major financial impact and low frequency.

We Are Certified By A Third Party Food Safety Auditor

There is no food safety certification or regulatory approach which entirely eliminates product contamination risk. Audits and certification may demonstrate compliance with certain standards, but they do not prevent accidents that result in product contaminations.

We Manufacture A Low Biological Risk Product

All food products are at risk, even if they present a low risk for pathogens. Allergens, whether by cross contamination or mislabeling, represent the leading cause of product contamination and recalls.

We Have Never Had A Major Recall

The frequency and severity of product contamination events has increased due to changes in the food and beverage industry. Tighter regulatory requirements have been introduced, supply chains have become increasingly complex and early pathogen detection has improved.

We Outsource Manufacturing

Recourse against contract manufacturers depends on their financial health and willingness to assume liability. A large contamination event may drive a manufacturer (particularly a smaller one) into bankruptcy. Long-term damage (brand and loss of sales) is difficult to quantify and business may not recover.

We Have A Robust Food Safety Program

Zero risk does not exist. The best food safety program may reduce the likelihood of a product contamination, but does not eliminate the risk. Accidents do happen and when they occur a company has to be able to manage the consequences.

We Audit Our Suppliers

Audits provide a snapshot of the suppliers' operations and can attest to the existence and effectiveness of preventive controls at the time of the audit. Accidental deviations may still occur and cause significant contaminations downstream. Also, audits cannot prevent intentional acts such as economic adulteration.

Global Food and Beverage Product Recall & Contamination Insurance Market

Carrier	Domicile	Accidental	Malicious
Ace European Group	Europe/ London	$15m	$15m
AIG (Lexington)	US/Bermuda	$35m	$50m
AIG (London)	London	$25m	$50m
Allianz	London	€50m	€50m
Allianz	US	$35m	$35m
Allied World	US	$15m	$15m
Apollo Consortium 9398	Lloyds	$10m	$10m
ArgoRe	Bermuda	$25m	$25m
Aspen	Bermuda	$10m	$10m
Berkley Specialty	US	$15m	$15m
Canopius Syndicate 4444	Lloyds	$15m	$15m
CFC	Lloyds	$10m	$10m
Chubb	US	$15m	$15m
Crum & Forster	US	$10m	$10m
CV Starr Syndicate 1919	Lloyds	$15m	$25m
CV Starr	US	$15m	$25m
Great American	US	$10m	$10m
HDI Gerling Industrial Insurance Company	London	€15m*	€15m*

Carrier	Domicile	Accidental	Malicious
Hiscox Syndicate 3624	London	$50m	$50m
Houston Casualty	US	$10m	$10m
Houston Casualty Excess	US	$15m	$15m
Liberty International	US	$15m	$25m
Liberty Syndicate at Lloyds	London	$15m	$25m
Markel	Bermuda	$25m	$25m
Markel	London	$25m	$25m
Novae Syndicate 2007	Lloyds	$10m	$10m
Pembroke Syndicate 4000	Lloyds	$15m	$15m
PLIS	Lloyds	$25m	$25m
SwissRe	US	$25m	$25m
SwissRe International	Europe/ London	$50m*	$50m*
Talbot Syndicate 1183	Lloyds	$45m	$45m
Tokio Marine Kiln Syndicate 0510	Lloyds	$20m	$20m
XL Insurance Syndicate 1209	Lloyds	$75m	$75m
XL Insurance	US	$75m	$75m
XL Insurance	Bermuda	$75m	$75m
Zurich Insurance plc	London	$25m*	$25m*

*Capacity only for non-US risks

The Mechanics of the Product Recall Claim Process

1. Root cause investigation process
2. Parties impacted by claim
3. Subrogation and risk transfer
4. Inventory tracking and management
5. Inventory destruction
6. Cash flow protection
7. Client loss analysis
8. Customer loss analysis
9. Claim settlement

Contact Information

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