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BUYERS REPORT
News & Trends For Risk Managers & CFOs

Buyers Should Beef Up Coverage, With Food Exposures Expanding

BY DAVID Y. LOH

Given the global nature of business and the abundance of food contamination recalls within the last few years, it’s critical that risk managers of U.S. food importers and exporters take advantage of specialized insurance products to protect against catastrophic risks.

A broad range of insurance products are available to respond to the food contamination context. Ideally, any company involved in food manufacturing or distribution should purchase at least one specialized insurance product, such as product recall or product contamination coverage.

At the top of the list for all companies is general liability insurance, which covers sums that an insured becomes legally obligated to pay as a result of bodily injury or property damage.

Such coverage is normally triggered by an occurrence—such as direct physical loss or damage—and usually covers legal fees and expenses incurred defending the insured from third-party lawsuits. But while general liability insurance protects an insured from third-party claims, it doesn’t normally reimburse an insured for loss or damage to its own food product.

Bodily injury pertains to third parties who allege sickness or death arising from food products manufactured, handled or stored by an insured. The concept of property damage is more complex, because:

➤ The insured may manufacture the food.
➤ The insured may or may not package its own food.

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◆ The insured’s food may be contaminated with other food products—pre-cut salad, for example.
◆ The insured may simply be involved in buying, selling or distributing food.

In addition, general legal liability often contains significant exclusions, such as product recall and pollution, which have particular application to the food contamination scenario.

For example, a product recall can result from government action or the insured’s own decision. In such instances, the product itself may not be physically contaminated but is removed on a voluntary basis by the insured.

In this case, the insurer would not consider a product recall to be caused by an occurrence—any physical loss or damage to the product itself.

In certain situations, even when the insured establishes food contamination, an insurer can seek to deny coverage under various exclusions.

For example, most policies contain a pollution exclusion which normally excludes a “bodily injury” or “property damage” arising out of the actual, alleged or threatened discharge, disposal, seepage, migration, release or escape of “pollutants.”

“Pollutants” are generally defined to include “any solid, liquid, gaseous or thermal pollutant or contaminant, including waste.” Depending on how the pollution exclusion is drafted, it is easy to see how an insurer may seek to exclude many forms of food contamination.

SPECIALIZED PRODUCTS

To avoid future contamination problems, it may be wise for a risk manager to consider purchasing specialized insurance products, such as product recall and product contamination.

Product recall insurance may include business interruption coverage for recalls, as well as replacement of tainted products and incidental costs directly related to a covered risk or peril. Product contamination insurance covers an insured’s financial losses arising from tainted foods.

The precise wording of policy language, always subject to judicial review, will determine whether these products cover a specific loss arising from contaminated or tainted foods.

These types of specialized insurance products are especially important today, when insurers are obligated to recall food products because of government regulators or to maintain goodwill.

In many instances, a food recall or contamination scare is generated when there is no direct evidence of physical loss or damage.

Depending on the reach of a particular food contamination case, potential targets of liability may include a broad list of businesses, including growers and fertilizer manufacturers, continuing through packagers, distributors and other points of sale, such as food processors, retailers and restaurants.

Government regulators in the United States and overseas will likely react by strictly enforcing existing regulations and enacting additional regulations, which could negatively impact food production generally—and particularly, imported foods.

POLICY FEATURES

First-party policies are specifically designed to offer coverage for physical loss or damage to an insured’s own food product. They are divided into two types:

◆ All-risk policies, drafted to provide coverage to all risk of physical loss or damage, unless there is an applicable exclusion.

◆ Named perils policies, designed to cover physical loss or damage caused by specifically cited risks.

A significant difference between these policies is that the insured need not establish the cause of the loss in an all-risk policy, only that the property in question suffered fortuitous loss or damage.

In the named perils policy, the insured usually has the initial burden of establishing that the physical loss or damage was caused by one of the specific enumerated perils mentioned in the policy.

Meanwhile, two types of clauses in first-party policies bear some further explanation:

◆ Control of damaged goods clauses can be significant, depending upon how they are drafted.

◆ Some clauses require that an insured consult with, or at least notify an insurer prior to destroying food that is allegedly contaminated. This is particularly sensitive when there is a potential threat of food contamination and the cost to physically test the food for contamination could be costly.

Other control of damaged goods clauses give the insured virtual autonomy to handle its product in any way it sees fit.

◆ Some labor clauses are commonly inserted into first-party policies to encourage the insured to take all reasonable steps to avoid a loss, or to lessen the effect of a loss.

This clause requires the insurer to reimburse the insured for the out-of-pocket expenses incurred to protect the product. For example, if an insured’s product is declared unfit by a government, and the insured must file suit or retain additional experts to overturn the government’s prior determination, the insured’s expenses would be recovered under the sue-and-labor clause.

The goal behind the clause is to minimize the risk through the insured’s actions, as the insured is best positioned to act quickly and promptly.

If the insured could have taken reasonable action to avoid or minimize a loss, and fails to do so, however, the insurer may have an additional basis to deny coverage, because the insured always has the non-delegable duty of acting as a prudent insurer.

If these products are too expensive for an organization, or the risks deemed too remote, an in-depth analysis of the current coverage is certainly warranted.

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