

## **Product Recall: Insurance for the New Age?**

By Greg Doherty

Published: April 23, 2009

Natural Products Insider

The dietary supplement industry has not escaped the product recall spotlight that so many American companies dealt with recently. From peanut butter products to weight loss supplement products, both voluntary and involuntary product recall campaigns are more frequent and costly than ever before. Add to that the recent mood change in Washington, as the new administration faces pressure to clean up the food, drug and supplement industries.

Just last year, Congress considered the Food and Responsibility Act of 2008, which contained a provision that manufacturers of consumer products possess sufficient means (through insurance or otherwise) to cover the entire cost of a recall of their product, including administrative costs, compensatory damages and costs of any product liability or other lawsuit relating to that product. That bill did not pass, but there is speculation that a similar law will be a priority of the new administration.

### **Expert Says:**

Loren Israelsen, executive director, United Natural Products Alliance (UNPA): "Our advisors in Washington predict FDA will receive new funding and enforcement powers, including mandatory recall authority for foods, which will likely include dietary supplements. No longer will FDA have to go to court to force a company to conduct a recall. As we have seen, product recalls unfold rapidly and are expensive to conduct. This new insurance will cover the cost of an FDA-mandated recall or a necessary voluntary recall (subject to the "covered event" trigger). It may also be the difference between survival and extinction for a company that experiences a severe recall event."

### **Evolution of Insurance Needs**

Many people remember the "Tylenol murders" of 1982, which caused Johnson & Johnson to recall its popular painkiller after it had been tampered with. Although a form of product recall insurance was available before that event, it was little known and less used. After the Tylenol event, this insurance came to the forefront and quickly became known as malicious product tampering insurance. Later, the coverage was expanded to include products that had been accidentally contaminated. Over the years, coverage was further expanded to include coverage for product extortion, loss of profits from a covered recall event, and loss control and crisis management services for a policyholder, the latter paid for by the insurance company as part of their service package.

Does commercial general liability insurance (a.k.a. product liability) respond to expenses and damages associated with a product recall? In fact, it will not. The courts have firmly established

that a general liability policy will only cover bodily injury that has already taken place.

In the case of Tylenol, or any of the other recalls where there was bodily injury to victims, the product liability policy generally provided coverage. The simultaneous but separate product recall is undertaken with the idea of preventing bodily injury and, thus, there is generally no coverage for a recall in a product liability policy.

Even with coverage enhancements over time, the market for product recall insurance remained narrow, with just a handful of companies offering it, which meant reduced competition for the insurance that was offered. However, this was also partly a function of low demand, as many companies took the “it will never happen to me” attitude.

A second problem existed as well. Most of the insuring forms were crafted with the retailer of the product in mind. This was not surprising, as the history of U.S. recalls shows many involved large consumer products companies that manufactured and sold their own branded products. But as a practical matter, these insuring forms for retailers did not “fit” for their suppliers, who also needed some form of insurance protection if they were found to be the cause of a product recall.

## **A Solution Emerges**

Recently an “A” rated (by Bests Rating Guide) insurance company introduced a policy that not only fit the product recall need of retailers, but also the needs of their suppliers. This is done with a two-tiered method of insuring agreements in the policy.

Coverage A is designed mainly for the retailer of the product and will cover expenses associated with a product recall event, including:

- Notification and communication costs
- Shipping costs
- Actual costs of product disposal
- Consultant expenses and related costs

Coverage B is the new coverage that protects the suppliers. Called product recall legal liability, it is designed for liability ultimately assigned by the tort system to the retailer's supplier(s), be it a raw materials supplier or contract manufacturer.

There are two noteworthy features of this coverage. First, whether a recall event is voluntary (e.g., not mandated by a regulatory authority) or mandated, the recall would similarly be covered if the key coverage trigger were met and no exclusions applied to negate coverage. That trigger is called a “covered event” and is essentially defined as the necessity to recall a product because the use or consumption of a product has resulted in bodily injury, or because the use or consumption of a product poses actual or imminent danger of resulting bodily injury.

Product Recall Legal Liability Coverage also includes the insured suppliers' legal obligation to pay compensatory damages, including, but not limited to, the recall expenses (including the cost to repair or replace any product) and the loss of profits (business income) the customer incurs from the recall incident.

The underwriting data required to obtain a quotation is similar to the data needed to get a product liability quote. Underwriters will want to understand your core business, but will also focus on issues such as:

- **Imports.** Imported products have increased approximately 217 percent from 1997 to 2007 and many recalls have been of imported foreign products.
- **Quality-control programs.** Is your company in compliance with FDA GMPs (good manufacturing practices) or on the way to becoming compliant? What are your testing and recordkeeping procedures for both incoming and outbound products?
- **Product liability losses.** Has your company had any product liability losses in the past that might be a harbinger of future recalls?
- **Revenue.** A revenue estimate will have a direct effect on the amount of your premium. However, unlike a typical product liability policy, the premium will be flat and not subject to an audit at policy expiration.

#### Expert Says:

Dick Griffin, insurance consultant: "This insurance has been available for years in various forms, but this new coverage is specifically designed for all members of the commerce chain. It may be perfectly timed for the new era of product oversight we are living in. It is difficult to predict how much this insurance will cost, but I would encourage companies to get a quotation and become familiar with the specifics of the policy. It may be sooner rather than later that some type of product recall insurance protection will not be just a good idea, but also the law of the land."

Product recall insurance (including product recall legal liability for suppliers) may not be a part of a company's current insurance portfolio. But in today's world of instant media sensationalism of product safety incidents and aggressive lawyers, product recalls can happen almost overnight.

*Greg Doherty is with Los Angeles-based Poms & Associates Insurance Brokers Inc. He is a broker specializing in the dietary supplement industry and is a member of the Consultants Association for the Natural Products Industry (CANI) and the American Herbal Products Association (AHPA). Doherty can be reached at (818) 449-9317 or at <mailto:gdoherty@pomsassoc.com>.*