# Brands At Risk

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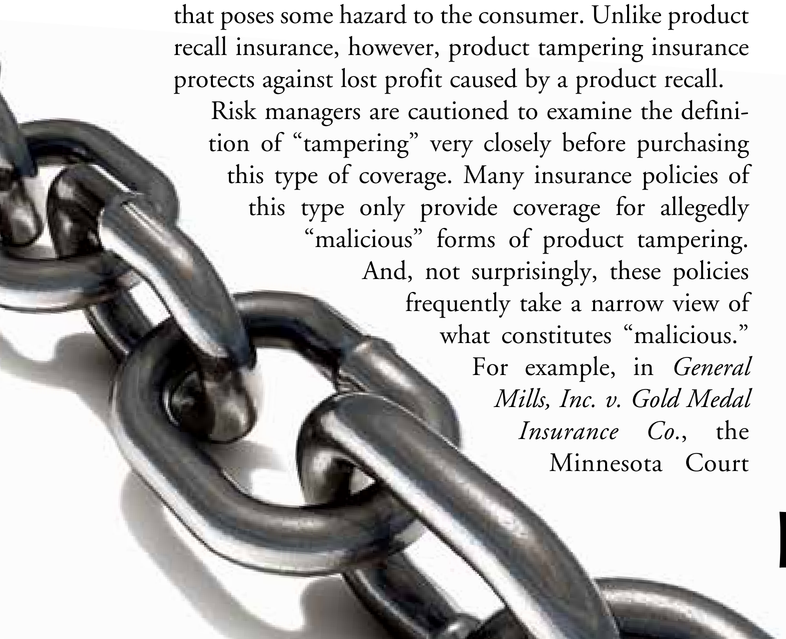
The exchanges between the different entities that constitute a supply chain can provide numerous openings for substandard or counterfeit goods to enter the legitimate stream of commerce. These substandard components can compromise the quality of the manufacturer's goods, diminish the manufacturer's brand equity, impose huge expenditures for investigations, testing and product recall, and create the potential for debilitating lawsuits, especially if consumers have suffered bodily harm. Even end-users, such as bulk purchasers of spare parts, components and finished goods, will not be spared these perils.

It takes only one weak link in the supply chain to create real issues. So it is not surprising, then, that the insurance industry has introduced product recall and product tampering insurance, which they claim will cover losses arising out of supply-chain crises. Risk managers are advised to read the fine print, however, lest they find that they have not only been cheated by counterfeiters, but by their insurance companies as well.

Product recall insurance purports to cover against the costs of recalling products, including products that are deemed to have been manufactured using counterfeit or otherwise faulty components. Product recall insurance may cover the cost of notifying customers about the recall; collecting and shipping the product back to the plant; repairing and returning the items to customers; and disposing of those items that cannot be repaired. Most product recall insurance, however, excludes coverage for lost profit caused by a product recall, or against liability claims from people injured by an allegedly faulty product—the primary costs associated with a product recall.

Like product recall insurance, product tampering insurance pays the costs of recalling and fixing a product that poses some hazard to the consumer. Unlike product recall insurance, however, product tampering insurance protects against lost profit caused by a product recall.

Risk managers are cautioned to examine the definition of "tampering" very closely before purchasing this type of coverage. Many insurance policies of this type only provide coverage for allegedly "malicious" forms of product tampering. And, not surprisingly, these policies frequently take a narrow view of what constitutes "malicious." For example, in *General Mills, Inc. v. Gold Medal Insurance Co.*, the Minnesota Court of Appeals, applying New York law, held that malicious product tampering requires a subjective intent to injure the policyholder.



In the 2001 case, the food manufacturer General Mills hired an independent grain contractor to treat its grain stocks with an FDA-approved pesticide. Unbeknownst to General Mills, however, the contractor intentionally substituted a cheaper but unapproved pesticide. General Mills' losses, including destruction of oat stocks and finished products and cleaning costs, were approximately $167 million, plus interest and costs.

AIG had sold General Mills a malicious product tampering policy. Although General Mills eventually settled with AIG for $17.5 million, AIG contended, and the trial court agreed, that the independent grain manufacturer acted with ordinary, but not actual, malice because "although he knew it was wrong to substitute [the pesticides], he assumed that the substitution would never be discovered and that no one would be harmed by his action. In the absence of a desire to injure the policyholder, General Mills, the court held that [the grain manufacturer] lacked the actual malice to trigger coverage under the National Union policy."

The Court of Appeals affirmed the trial court's decision, stating that the language of the National Union policy requiring "intentional, malicious and wrongful" tampering went "beyond the mere commission of a wrongful act; it includes the concept of intending to harm, which is within the definition of actual malice."

Risk managers seeking to secure coverage for supply chain type risks such as the one described above should carefully review proposed policy forms to ensure that intentional acts of tampering will be covered whether or not there was an intent to cause harm to the consumer. Risk managers may also wish to see if "accidental tampering coverage," which generally covers "inadvertent or unintentional" acts of contamination, is available.

With any new risk comes a host of new insurance products. Before signing up for the next big thing—and paying a hefty premium for the privilege—it is important for risk managers to make sure that the coverage they are paying for actually covers the risk they seek to insure against. This is particularly true in the area of supply chain risk and product tampering. Insurance companies are paying attention to this area, and protecting themselves from potentially astronomical losses. Risk managers owe it to themselves and their employers to pay attention as well. ■