

TERROR ON THE SHELF

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PUBLIC opinion can quickly turn against a popular brand name product — if consumers feel there is the risk (however slight) of death or bodily injury. Gradually, large companies with valuable brand name products' are appreciating the consequent risk to themselves of their products being deliberately contaminated. After all, if a company's building burns down, there is no loss of public confidence in the product. If, however, there are well-publicised threats to poison a product, not surprisingly, the public will stop buying. Brand loyalty is not so great that the public will risk their lives in supporting a product.

A typical example of what can happen was the Mars Bars episode, a few years ago. A certain protest group claimed that contaminated bars had been placed on the shelves of shops. Bars, which really had been contaminated with rat poison, were received by the *Sunday Mirror* and the BBC. In fact, no other bars had been poisoned. The cost for Mars, in terms of lost sales, has been estimated at £2.8 million.

Whatever may be the initial problem for a company, it is likely to be compounded by the media, and the cost can be considerable. Clearly, therefore, there is no truth in the saying that there is no such thing as bad publicity. Even though there may have been no risk to the public (the whole event having been a hoax), a small company can be brought down simply by a threat. In many cases, a not particularly large loss will wipe out future profitability.

If one takes a company where the profit margin is 5% of sales, and there is a loss of this type, outside all budgeted expectations of, say, \$100 000, sales would have to be increased by \$2 million to make good that loss. Insurance against tampering with products and contaminating them has been introduced to provide compensation for manufacturers whose products (typically, food, drink, pharmaceuticals, tobacco and cosmetics) have suffered from deliberate tampering, or are even believed to



have been deliberately contaminated in some way.

Food manufacturers have been bearing the brunt of the attacks, but the position could well change. So far, most of the demand for this type of protection has come from America and Britain, with their stricter liability regimes for products. Now there is growth in western Europe and interest from Australasia, the Far East and Scandinavia. In the main, it has been the larger corporations which have shown most interest, so far, with, in some cases, demand

exceeding the current market capacity of some \$60 million, or more.

Having said that, it is probably the smaller companies, requiring an indemnity of, say, between \$5 million and \$20 million, which are the most vulnerable without this type of protection. There are probably a number of reasons for the apparent inactivity of smaller companies. First, they or their local brokers may not be aware of this type of protection, or be sufficiently informed about it. Inevitably, cost can play an important part when any new form of insurance is being considered. In a time of recession, there is a natural tendency to avoid incurring fresh expenditure, but it could be argued that, for some companies, the brand name of a product can be a greater asset than the company's bricks and mortar.

One problem has been that, while insurers look upon product contamination as being related to risk, manufacturers see it as related to effect. As a result, it is quite common for a manufacturer, on receiving a quotation for malicious contamination insurance, to compare it with the premium being paid for product liability insurance. The manufacturer then fails to see why the former should be so much higher than the latter, especially when the latter is seen as core insurance for a manufacturer, with the former still something of a novelty.

One suggestion within the market (which, so far, has not made a great deal of progress) has been to offer a wide-ranging policy in the form of product protection. This covers not only recall, but also rehabilitation, loss of profits



and suchlike for contamination — virtually however caused. It was felt that such an approach might be more acceptable to manufacturers and, at the same time, expand insurers' premium base.

One of the difficulties in providing such cover is that, while insurers are ready to cover risks such as malicious contamination, which are outside the control of the insured manufacturer, they are not too confident about the ability of manufacturers, in general, to avoid problems which are perceived to be under their control. As the market for malicious contamination insurance has expanded, the cover has become more sophisticated. Now, such a policy covers intentional malicious and wrongful alteration or contamination of an insured product, rendering it unfit or dangerous, or merely creating such an impression to the public. A claim, therefore, is payable whether the tampering is actual, or merely threatened (as, so often, is the case).

The insurance covers the cost of recalling products, and the cost of reimbursement for those products. If the contamination, or threatened contamination, is at the factory, it is the actual costs of the manufactured product or raw materials (as applicable) which will be payable. In addition, there is cover for the cost of destroying products, and the cost of replacement on the shelves of retailers. Loss of net

profit is covered over a period of up to 365 days. In addition, there is cover for rehabilitation costs (for example, the advertising campaign to restore sales, special promotions and so on). Typically, the limit of indemnity for rehabilitation costs may be 25% of the overall sum insured.

This comprehensive form of insurance also covers any necessary laboratory work, or other consultancy fees, such as the retention of psychiatric or legal experts, or those specialising in security or recall programmes. Also included as part of the package can be expert public relations, to provide discreet reassuring of customers. A complete operation can be provided for dealing with enquiries over the telephone, so that, as far as possible, the targeted company can continue to operate normally. One company was faced with 1000 callers an hour telephoning its central switchboard when an incident became public knowledge. Clearly, failure to control those calls could have resulted in temporary and damaging closure of the company's operations.

The insurance applies to the product or range of products which have suffered from actual or threatened tampering. A claim, therefore, cannot be made by a manufacturer in respect of losses resulting from a drop in the sales of other products which have not been the subject of contamination or threat. There has been a

significant increase in capacity, as this type of insurance has been more widely appreciated.

When AIG entered this market in 1985, its capacity was \$5 million per risk. By December 1988, it had risen to \$15 million. After the entry of certain underwriters at Lloyd's, the market capacity rose to \$30 million or so. Now, the market's capacity is approximately \$60 million. As more business has been written, so there has been a reduction in the size of compulsory deductible. At one stage, \$15 000 was about the minimum figure, while one is now thinking of \$5000 to \$7000 as being the minimum. Incidentally, the practice has been for no deductible to be required for extortion insurance.

So far, it is chiefly the large companies which have been attracting claims. While it is still too early to tell whether the initial rating has been satisfactory, rates have tended to stay at much the same level for larger companies, while efforts have been made to make this class of insurance more economic for smaller companies. Certainly, there is considerable potential for growth, if companies appreciate the risks which they run, and how this insurance provides compensation. Much education still needs to be carried out. In a way, this type of insurance can be likened to directors' and officers' liability. That started slowly, and there was the need to stress to those involved that they ran the risk of being sued as a result of their daily working routine.

Ransom or extortion demands are not covered by a malicious product tamper policy. Such cover can, however, be bought and it is generally advisable for a manufacturer to have both types of protection. Each type of incident can turn into the other. What appears to be straightforward contamination may turn into a risk of extortion. Similarly, an incident which starts off as extortion, could become a contamination risk if it should not succeed from the extortionist's point of view — with his then gaining publicity by advising the press.

Naturally, it is advisable that a manufacturer should have both covers written by the same insurer. Not only should this secure a worthwhile discount off the extortion premium, but it avoids the problem of which policy should respond to a particular incident. Under an extortion policy, cover is provided for the actual extortion payment (if it is agreed it should be paid), although, as is customary with kidnap and ransom insurance, initially the insured company is responsible for the actual payment, subsequently seeking reimbursement from the insurers.

Cover, also, is provided while the payment is in transit. And the protection applies if the money is taken by the wrong people — which has happened on occasions. While much of the cover under extortion insurance is similar to that for malicious product tamper, there is no

rehabilitation cover, and any claim for loss of net profit is limited to 30 or 60 days (rather than the 365 days under the malicious product tamper policy).

Perhaps surprisingly, many cases of actual or threatened contamination are intended to secure publicity for a cause, rather than to raise funds. Only about 14% of those who make demands are intent on collecting money. It appears that some people threaten to contaminate products because they want the targeted company to suffer from bad publicity — perhaps in connection with an aggressive takeover bid. Or a disgruntled employee may want to take revenge. And there are plenty of cases of groups with special interests such as the one which attacked Mars, mentioned above. Nevertheless, there are some who are keen to achieve publicity and, at the same time, secure cash. Their demands can be high, with a figure of £15 million having been reported in one instance.

Market capacity for extortion insurance is about \$100 million, and it is customary for no deductible to be required by insurers. Where both types of insurance are in force, an insured can be expected to use the extortion policy in the first instance (where appropriate), in view of the fact that there is no deductible, and then to make use of the malicious product tamper insurance.

Features taken into account by insurers in assessing premium are corporate size and the anticipated exposure. Here, one is thinking of the types of product, where they are sold, their shelf life, and whether there have been previous recalls or tampering incidents. A company's procedures for controlling quality will also influence the premium as will plans to manage crises.

All in all, this is a form of insurance which has the advantage of being short tail, and where useful new premium income can be generated for insurers, provided companies at risk can be made aware of the protection which is available for them, and can be persuaded to pay a level or premium which reflects the risk involved. Sadly, 'consumer terrorism' is likely to grow, and expand geographically, rather than diminish. This, therefore, is likely to be a form of insurance for which there will be continuing demand in the foreseeable future. ■

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