

Risk Mitigation Strategies for Food and Beverage Companies: *Five Prophylactic Measures*

by Kent J. Schmidt

Each year, food, beverage and agribusiness companies pay millions of dollars in settlements, penalties and judgments to consumers allegedly harmed through the sale, advertisement and manufacture of their products. The legal hazards that stem from the sale of food and beverages range from the single contamination claim to the nationwide consumer class action alleging that individuals were misled about an ingredient in a product. Some claims have merit while others are frivolous by any reasonable standard.

Faced with these real and varied risks, a prudent market participant must continually assess and refine its litigation and regulatory risk mitigation strategy. Devising a liability risk profile that identifies key areas of vulnerability can bring into focus what would otherwise appear to be dauntingly nebulous and undefined liability scenarios. An effective litigation risk mitigation strategy for food and beverage producers considers the unique aspects of the product and the nature of the customers and distribution channels. The plan evolves with the business as it grows. Effective implementation requires substantial resources and a commitment from varied disciplines and professions: food scientists and technologists, members of the sales and marketing team, key executives, outside consultants and vendors such as insurance brokers, to name a few.

The starting point in this process is to identify the three types of claims typically brought against companies in the food and beverage industry. Excluding intellectual property claims, most food and beverage litigation relates to one or more of following three categories:

- **Product liability claims** in which a consumer is injured or becomes ill by the food or beverage—e.g., adulterated food or undisclosed ingredients causing allergic reactions;
- **Breach of warranty claims**, particularly in the B2B context, which are governed by contract terms and the Uniform Commercial Code; and
- **False advertising and consumer protection claims** alleging misstatements or omissions on food labels and advertisements about the product, its ingredients or origins or deception relating to the packaging (“slack-fill” laws).

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The obvious prophylactic measures that most companies undertake in the normal course include ensuring compliance with FDA and state food safety regulations, submission and adherence to Sanitary Standard Operating Procedures (SSOPs), Hazard Analysis and Critical Control Point plan (HACCP) and scrutinizing advertisements and food labels. Beyond these obvious steps, one might consider five risk mitigation strategies that, if not overlooked entirely, are not always exploited to the fullest extent advisable.

1. Analyze Insurance Coverage and Third-Party Indemnity Issues

A natural place to begin in the assessment of any risk mitigation is insurance and related indemnity strategies. While any responsible market participant has a standard general liability in place, many companies do not take full advantage of the opportunity to transfer risks to third parties.

The first step is to re-examine insurance policy language, bearing in mind the precise types of claims that are likely to be brought relating to the food or beverage. The exclusionary language in the policy, sometimes skimmed over when the coverage is placed, becomes a central focus after a claim has been asserted at which time words and phrases are parsed in an almost hermeneutic fashion. At that point, it is too late to remedy newly-discovered gaps in coverage. The better time to engage in this analysis of coverage and exclusionary language is before the claim is brought.

A few of the many coverage questions that arise in this space relate to exclusions for advertising injury, whether claims for lost profits of third parties are covered, and out-of-the-ordinary claims that arise from a particular type of product defect. For example, a policy that covers food contamination may not cover a claim arising from glass or other foreign objects in the food or beverage.

But insurance coverage is not the only way a party can contractually shift litigation risks to third parties. Contracts containing indemnity provisions can produce a similar result. Think strategically about contractual allocations of risks all the way through the chain of distribution, including ingredients, packaging and other component suppliers.

Suppose a food product that a company is manufacturing uses an ingredient that is contaminated or has a similar defect. A prudent manufacturer using the contaminated ingredient from a third party may find it useful to have an indemnity provision in a supply contract pursuant to which the claim may be tendered to the vendor of the defective ingredient. But suppose further the vendor is now insolvent or judgment proof or the vendor is abroad and beyond the actual jurisdictional or practical reach of U.S. courts. Another option is to require that all ingredient and packaging providers secure an insurance policy covering the risk of loss arising from a contamination and naming the manufacturer as an additional insured.

These types of indemnity provisions can be utilized throughout the distribution chain, from farm to table. Consideration of the possibility that a product-related claim might be compounded by another party's failure and insolvency or lack of insurance is a key step

in mitigating against product-related litigation risks.

2. Negotiate and Effectively Implement Robust Terms in B2B Contracts

This leads to the second step in mitigating against food and beverage-related claims: carefully negotiating and reviewing key terms in business-to-business contracts with a focus on the rights and remedies available when things go south. The dozens if not hundreds of contractual relationships created in the farm to table chain of distribution involve many contractual arrangements varying in degrees of sophistication and detail. In each of these bargained-for-exchanges of consideration, various provisions and protections can be negotiated to address scenarios when a product triggers a claim. Here are some of the contract provisions that might be considered:

- From the sellers' perspective, one of the most important contractual provisions is to effectively and conspicuously limit the scope and duration of various warranties, including disclaimers of implied warranties or any other deviations from the standard specifications.
- It may be possible to circumscribe the remedies available to the buyer, including a reasonable liquidated damages clause and with clear and unequivocal disclaimer of all liabilities for lost profits and other losses.
- In that same vein, thought should be given to the remedies in the event that a few non-conforming units are defective and whether the buyer may reject the entire lot or has more limited recourse.
- For ingredient and packaging manufacturers, the extent to which a party in the chain of distribution must test and inspect products or components before accepting and incorporating into the ultimate product should be clearly stated.
- A provision limiting the time in which a lawsuit or other claim can be filed may be important along with arbitration, venue and choice of law provisions.

A common unforced error made by many is to shore up their written contract language with favorable terms only to find in litigation that those terms are not treated as operative. This is how contract terms are set aside by courts. In B2B transactions, terms and conditions printed on the reverse side of invoices are sometimes neglected, not retained, or canceled out by the buyer's own terms and conditions resulting in what the Uniform Commercial Code calls the "battle of the forms."

The takeaway here is that it is important to not only review the contract terms but ensure that, with respect to each B2B transaction, those favorable terms become part of the bargain and enforceable to defend against claims. In some instances, a master supply agreement should be negotiated in which the parties expressly agree that those terms cover all transactions, irrespective of the competing terms on preprinted purchase orders and invoices.

3. Make Internal Critical Assessments a Benefit Rather than the Bane of Future Litigation

The next risk mitigation strategy relates to the creation and control of documents about the product and related food safety issues that may be discoverable in litigation. These internal critical assessment documents, of great interest to a plaintiff's lawyer, may

include robust internal debates, scathing criticisms of current food sanitation systems, the need for enhancements in design of a product or shoring up disclosures on a label. There are often disagreements within an organization about a proper response to consumer complaints or whether a marketing claim has sufficient supporting data. The resulting emails and paper trails can provide ammunition to a plaintiff's lawyer in litigation and provide support to an otherwise weak claim.

An unavoidable tension exists between the need to engage in free and open communications about food and beverage safety and quality and the danger those very well-intentioned documents will be used in litigation. A few jurisdictions, recognizing this tension and the need to encourage open and free communications in this context, have adopted an evidentiary privilege of critical self-assessment, excluding such documents from evidence. But the contours of the critical self-assessment privilege are far from clear and provide little assurance that such communications will be protected from discovery in litigation.¹

How does a company balance the need to encourage open and free communication among employees while at the same time avoiding the creation of “smoking gun” emails in subsequent litigation? Here are three ideas:

- **Employee Awareness:** The first step in addressing the problem is to acknowledge that it exists, which is more than many companies do. Employees throughout the organization must understand how the statements they make in an email may not only be discoverable in litigation, but become some of the most critical documents in the case. An email exaggerating the severity of a problem or concern, perhaps sent without all of the facts or with a focus on organizational issues and only tangentially related to a food safety issue, can be difficult to walk back during a deposition. Everyone from the senior executives to the shift supervisors must understand this balanced and somewhat nuanced message. Employees should not misunderstand company statements about emails and other writings as a directive to suppress concerns but only to be prudent in how those issues are expressed in emails and other writings.
- **Meetings and Calls Rather than Emails:** Some matters are best addressed in face-to-face meetings or phone conferences rather than an endless string of emails in which each person pontificates on a sensitive issues.
- **Close the Loop:** When issues are raised in any email or other writing, and a remedy is implemented, that resolution should be documented and the writing preserved. If a concern merits the creation of a formal or informal writing, its resolution should similarly be in writing and that writing retained.
- **Involve Counsel on Key Issues:** While the contours of the critical self-assessment privilege are undefined and its recognition limited, the attorney-client privilege is universally recognized and protects most communications made in the context of obtaining legal advice. But there are limits to the scope of this privilege and the attorney work product doctrine. The quality assurance personnel cannot simply copy in-house counsel on every email under the guise of seeking legal advice. Where legal advice is sought, particularly in connection with a specific incident—for example, the early stages of a product recall—including counsel in the discussion presents the additional benefit of protecting the communications from discovery in litigation.

4. Know the Current Trends in Food and Beverage Class Action Litigation

It is commonly known that the food and beverage industry has been the target of a spate of consumer class actions in recent years, particularly in California. The Ninth Circuit has earned the nickname “The Food Court” as it sorts through a voluminous docket of class actions alleging that consumers were misled about the food and beverages they consume. Food and beverage companies would do well to heed the current trends, paying particular attention to cases involving competitors or those selling similar products.

Here are some of the of most common consumer cases against food and beverage companies:

- **All Natural, Organic, GMO, Ingredients:** At the top of the list are class actions alleging false or deceptive claims about the nutritional or other qualities in food or beverage. These range from the definition of a micro-brew, organic certifications, whether ingredients qualify as “all natural,” the presence of GMOs and similar ingredient claims.²
- **Origin Claims:** In addition, a number of claims regarding the origin of the food and beverage products continue to be filed.³
- **Greenwashing and Fair Trade:** As consumers of food and beverages become more attuned to socially responsible choices, sellers are increasingly touting their product’s ecological benefits or that it is procured through “fair trade.” These claims, if not substantiated, can lead to consumer claims of deceptive advertising.⁴
- **Slack Fill Statutes:** Both regulators and California consumers are bringing claims relating to the slack fill—the space in a container of a product compared to the actual volume. Slack fill regulations prohibit a seller from deceiving consumers about the contents through packaging that is deceptive.⁵
- **Social Media Campaigns and Product Endorsements:** A relatively recent area of concern relates to the advent of social media as a means for advertising. The FTC has taken action against companies paying individuals with large social media followings to endorse, tweet or post about products without disclosing to the public that this is a paid endorsement.⁶
- **Prop 65 Warnings:** Although this California law has undergone several reforms in recent years to curb abuses, there has been no drop off in the number of actions and settlements relating to the alleged failure to warn about carcinogens and chemicals deemed to increase the risk of cancer or cause reproductive harm.

Knowing the recent trends and what types of claims are being filed against competitors or others in the same space is an important aspect of reducing the risk of similar claims.

5. Create a Crisis Management Plan for a Doomsday Scenario

The fifth prophylactic measure is based on the assumption that, notwithstanding the foregoing strategies and a host of other best practices, a crisis will arise at the most inopportune time. These crises take many forms. Besides preparing for run-of-the-mill commercial litigation disputes, one must anticipate a massive food recall, a disparaging tweet about product quality or contamination that goes viral, a surprise visit from the FDA that shuts down a factory or a class action lawsuit with intrusive and burdensome discovery. In some crises, decisions normally reached over many days of deliberation

must be made in hours or even moments.

To avoid being caught flatfooted, a company should develop various crisis management plans well in advance, outlining a plan to swiftly convene a team of key executives and outside consultants and implement a response. Here are some questions that should be carefully considered as part of this plan:

- Who will take the lead and what members will fill out the team, including quality, root cause analysis, public relationship, customer response, insurance and legal?
- What steps will be taken to trace the problem through control numbers and product coding to ensure that the scope of a food recall is appropriate to the defect?
- How will the public's right to know be addressed and what regulators must be informed?
- Who are the contacts in other organizations in the chain of distribution who need to be brought into the discussions and analysis, and who will interface with them?
- Who is running the social media response when this problem hits the Twittersphere?

These and other questions must be addressed in a well-crafted crisis management plan so that, rather than focusing on these threshold and structural issues, all time and attention can be devoted to finding a path out of the woods.

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The challenges to succeeding in the business of growing, processing and selling food and beverages to the public are daunting enough without the potential of costly litigation or regulatory challenges. But with careful planning, including consideration of these five strategies, many of potential claims and legal risks can be avoided.

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¹ The critical self-assessment privilege was first recognized in *Bredice v. Doctors Hospital, Inc.*, 50 F.R.D. 249 (D.D.C. 1970) *aff'd*, 479 F.2d 920 (D.C.Cir.1973), which held that minutes of hospital staff meetings regarding procedures to improve patient care could be protected from discovery in a malpractice suit because of the important public interest in having hospitals critically evaluate the quality of the care they provide. Since then, few courts have expressly recognized the privilege and most "seem reluctant to extend the privilege beyond the circumstances under which the privilege was first recognized." See *Williams v. Corelogic Rental Prop. Sols., LLC*, 2016 U.S. Dist. LEXIS 148752, at *18 (D. Md. Oct. 26, 2016).

² In California, these claims are typically brought under the False Advertising Law (Cal. Bus. & Prof. Code § 17500), the Unfair Competition Law (Cal. Bus. & Prof. Code § 17200) as well as the Consumer Legal Remedies Act which prohibits "[r]epresenting that goods or services are of a particular standard, quality, or grade, or that goods are of a

particular style or model, if they are of another” and “[m]isrepresenting the source, sponsorship, approval, or certification of goods or services” or the “affiliation, connection, or association with, or certification by, another.” Cal. Civ. Code § 1770(a)(2), (3) and (7).

³ Designation of origin claims are brought under both federal and state standards. See Cal. Bus. & Prof. Code § 17533.7; Cal. Civ. Code § 1770(a)(4) (CLRA prohibition against using “deceptive representations or designations of geographic origin in connection with goods or services”); 15 U.S.C. § 1125(a)(1) (the Lanham Act specifically prohibits using any “false designation of origin.”).

⁴ See e.g., 16 C.F.R. § 260 (Guides for the Use of Environmental Marketing Claims; Final Rule) (extensive regulations regarding various environmental claims routinely made by sellers of consumer products); Cal. Public Res. Code § 42359.6(b) (“a person shall not sell a food or beverage container in this state that is labeled with the term ‘biodegradable,’ ‘degradable,’ or ‘decomposable,’ or any form of those terms, or in any way imply that the food or beverage container will break down, fragment, biodegrade, or decompose in a landfill or other environment.”); Cal. Public Res. Code § 42359.6(b)(a) (“a person shall not sell a food or beverage container in this state that is labeled with the term ‘compostable’ or ‘marine degradable,’ unless, at the time of sale, the food or beverage container meets the applicable ASTM standard specification, as specified in subdivision (b) of Section 42359.5.”)

⁵ See e.g., 21 C.F.R. § 100.100(a) defining slack-fill as “the difference between the actual capacity of a container and the volume of product actually contained therein.”).

⁶ See 16 C.F.R. § 255.0 (Guides Concerning the Use of Endorsements and Testimonials in Advertising), Example 5 (blogger endorsements) and <https://www.ftc.gov/news-events/press-releases/2017/04/ftc-staff-reminds-influencers-brands-clearly-disclose>

Dorsey & Whitney is hosting a Food Risk Summit on November 30, 2017. Tom Vilsack, former U.S. Secretary of Agriculture and former Governor of the State of Iowa is the keynote speaker. Topics include Food Safety Issues; GMOs, Non-Milk Milk, and other Legislative and Regulatory Issues; Insuring the Risk of Product Contamination, Withdrawals from Market and Recalls; Labeling, Slack Filling and Contamination: Food Litigation Today; Betting the Company: Surviving a Recall; and Who’s Holding the Bag? Indemnity Agreements and Risk Transfers. For further details and registration, click [here](#).