Law360
A LexisNexis® Company
July 30, 2014

5 Tips For Food Cos. Looking To Outsource Production

By Ben James *Law 360 | New York*

Food companies that outsource production need to ensure their deals with manufacturing partners contain all the right ingredients and account for concerns such as quality control, labor issues and intellectual property protection, or else the arrangements can become recipes for disaster, attorneys say.

Although outsourcing can cut overhead costs, an array of pitfalls awaits food companies that are less than diligent when entrusting production to a third party. A failure to meet quality standards, for example, can evoke visceral reactions from consumers and tarnish a brand, regardless of exactly what caused the problem or which company ends up being on the hook financially.

"In the food and beverage industry, the product quality issue is magnified more than in any other industry," Carico Johnson Toomey LLP's William Benz said. "You can craft a contract that has all the right indemnifications and is well-designed, but if something goes wrong down the road, it doesn't help your reputation that much. Consumers see the name on the package."

Clark Hill attorney **R. Kevin Williams**

The common thread running through advice from food and beverage law specialists on outsourcing food production is the paramount importance of upfront planning.

John Shapiro, a member of Freeborn & Peters LLP's food industry team, drew a parallel between forging a good outsourcing relationship and putting together a general food safety plan to comply with U.S. laws and regulations. Both involve taking a close look at a business and identifying where food safety hazards might pop up, he noted.

"Outsourcing requires a great deal of due diligence and thorough preparation in order to identify, and then address, the potential pitfalls," Shapiro said. "An ounce of prevention is worth a pound of cure."

Here are five tips attorneys say companies should heed when outsourcing food production:

Pick the Right Partner

Selecting the right business partner is often the most important component of any business contract, and when it comes to outsourcing food production, it definitely is, said Dori Brewer, leader of Perkins Coie's food and beverage industry practice.

"The first, and probably the most important, thing in these contract manufacturing relationships is for the food company to choose a contract manufacturer that is experienced and reputable," she said.

Brewer likened the due diligence a food company should perform when eyeing an outsourcing partner to the scrutiny parents would give a childcare facility they're considering.

Steps ought to be taken such as visiting the premises, assessing its cleanliness, checking what certifications it has and looking into what other companies it does production work for, she said.

Clark Hill attorney **Jonathan M. Boulahanis**

Other key factors to consider are how long the potential outsourcing partner has been in business, whether it has experience with particular industries or specific products, its overall reliability and whether it can handle the scope of production that the food company needs, lawyers said.

"I think the most important thing by far is doing your due diligence on your outsourcing partner ahead of time," Benz said. "Putting the work in ahead of time will save you a lot of headaches on the back end."

Protect Intellectual Property

In addition to their brand and overall reputation, food companies that outsource production will likely have valuable intellectual property, including trade secrets, that they need to safeguard, Brewer noted.

"If you are providing some sort of proprietary recipe or method to your outsourcing partner, you have to take the steps with the supply partner necessary to protect your intellectual property," Shapiro said.

continued on page 2

continued from page 1

Nondisclosure agreements are commonly used to accomplish this, and Benz said an outsourcing partner should be required to sign a nondisclosure pact before accessing confidential information like recipes, sales data or distributor lists. Making sure an outsourcing producer's employees are bound by the NDA is crucial as well, he added.

The written agreement between the food company and the outsourcing producer should lay out who owns the intellectual property associated with a given product and bar the manufacturer from using that knowledge for any similar products, Brewer said.

Another step food companies can take to stave off the potential disclosure of sensitive information is to make a particular component — like a proprietary spice blend — in-house and then deliver it to the outsourcing partner as opposed to forking over the recipe.

"One way a food company can protect its trade secrets is not to give the contract manufacturer every piece of the puzzle," Brewer said.

Stay Vigilant

When a food company has found a good outsourcing partner and signed off on a precise and thoughtful contract, it can't just sit back and forget about it, lawyers say.

Maintaining some kind of ongoing oversight of the outsourcing relationship, which can include periodic product testing and visits to the manufacturing facility, is a must, Shapiro said.

"An outsourcing relationship requires vigilant oversight, and I recommend building into this relationship contractual rights that render the operations of the supply partner, including the identity of its suppliers, transparent to the outsourcing company," he said.

Brewer also stressed the importance of ongoing management of the relationship, citing that, along with pre-agreement diligence and putting the right contract in place, as integral steps to getting the most out of an outsourcing deal.

The agreement should give the food company the ability to show up and inspect the production plant at any time or on a few days' notice, she added.

Be Aware of Labor, Employment Issues

One benefit a food company can get from outsourcing production is not having to deal with the employment law headaches that come with having a staff of manufacturing personnel, Benz noted. Avoiding getting slapped with joint-employer status means staying away from exercising control over the outsourcing partner's workers.

"The best way to do that is the outsourcing agreement should specify that production personnel are not employees of the food company and that the food company will have no direct managerial control over them," he said. "You want to make sure that you're not reaching in and controlling the manner and the means in which the work is actually done. Essentially you're relying on the outsourcing partner to get done what needs to get done."

The federal Worker Adjustment and Retraining Notification Act, as well as any analogous state laws, also have to be considered if the outsourcing involves a mass layoff or plant closing. Under the federal WARN Act, workers must be given 60 days' notice of covered plant closings or covered mass layoffs.

"It's better to be cautious," Benz said. "You can give notice and pull it back, but if you don't give notice you can't retroactively do it."

Jonathan Boulahanis of Clark Hill PLLC pointed out that food companies contemplating outsourcing also need to think about any existing collective bargaining agreements with labor unions as well as any employment contracts that may exist with individual workers.

Factor In Cross-Border Concerns

Not every outsourcing arrangement has an international angle to it, but those that do come with their own unique issues and challenges. Companies need to be aware of and factor in the costs of bringing products into the U.S. when mulling an outsourcing pact that involves foreign operations, said Kevin Williams, a member of Clark Hill's customs and international trade law practice.

In addition to foreign taxes and duty rates , there may be import quotas — a ceiling on how much of a particular product can be imported without higher duty costs kicking in — to contend with, Williams said.

"Almost any product that contains a significant amount of sugar or dairy is going to be subject to these quotas," he said.

Food companies should also consider the impact of foreign outsourcing on their marketing efforts, Williams pointed out, particular if a company touts its products as U.S. made.

In addition, food companies should consider whether they can protect their intellectual property in whatever country they're considering outsourcing to, Williams said. Even if a contract has strong nondisclosure and confidentiality provisions, they may be difficult to enforce in some jurisdictions.

"Certainly, you would need to draft that stuff into your contract, but you need to consider enforceability as well," Williams said. "Some countries have better protections than others."

R. Kevin Williams is a Member in Clark Hill's Customs and International Trade Law practice group. He practices Customs and International Trade Law focusing on all aspects of the import and export process including tariff classification and valuation of imported merchandise, country of origin determinations, country of origin marking, intellectual property protection, anti-dumping/countervailing duty cases including representation before the International Trade Administration, Department of Commerce and the International Trade Commission, and retaliatory actions such as those taken under Section 301. **Contact him via phone: (312) 985-5907 or email: kwilliams@clarkhill.com.**

Jonathan M. Boulahanis is an associate in Clark Hill's Litigation and Labor and Employment Practice Groups, and is one of the Chicago leaders of Clark Hill's Food and Beverage Team. His practice includes commercial, business, and employment litigation, as well as advising businesses on labor and employment issues and litigation avoidance. He works with clients on legal issues that are common in the food and beverage industry. **Contact him via phone: (312) 985-5930 or email: jboulahanis@clarkhill.com.**