Total Recall: Exploring Insurance Coverage for Product Recalls
(INS010)

Speakers:
• Tabitha Prestler, Director, Risk Finance and Insurance, Wilbur Ellis
• Joann M. Lytle, Partner, McCarter & English
Learning Objectives

At the end of this session, you will:

• Understand the coverage available under a CGL policy for third party claims stemming from a recall
• Consider the impact the “sistership exclusion” can have on your business
• Explore the types of coverage provided by product recall policies
Product Recalls in the News
Kanan Pistachios

- Kanan Enterprises recalled natural in-shell pistachios due to potential salmonella contamination
- Recalled all bags sold on a specific date nation-wide
- Risk of serious and sometimes fatal infection
DiGiorno, Lean Cuisine, and Stouffer’s

• Recalled 12 product varieties based on the belief that the products may contain small pieces of glass
• No injuries have been reported
• Consumers are asked to contact customer service if they have purchased a potentially contaminated product
Perdue Chicken Nuggets

• Recall of approximately 4,530 pounds of chicken nuggets that may be contaminated with extraneous plastic

• Shipped to retail distribution centers in Florida, Georgia, Indiana, Massachusetts, Pennsylvania, New York, and Texas

• Encouraging consumers to throw away or return the recalled products
Bring Your Adventure Zipline

- Sports Skyline backyard zip line kits recalled due to a fall hazard
- Over 6,000 zip line kits recalled
- Nine reports of cable failure: six alleged injuries including three head injuries
- Sold for $100 - $130 each
KYMCO Utility Vehicles

- 1,700 utility vehicles recalled as a result of potentially failing throttles
- Sold for $8,000 - $8,700 each
- As of March 10, 2016, KYMCO received seven reports of throttle failure; no injuries reported
- Consumers can bring their vehicles to an authorized dealer for a free inspection and repair
Voluntary Or Mandatory?

• Most recalls are voluntary
• However, FDA has the authority to mandate recalls under certain circumstances
• FDA-regulated products subject to recall:
  • Human drugs
  • Animal drugs
  • Medical devices
  • Radiation-emitting products
  • Vaccines
  • Blood and blood products
  • Animal feed
  • Cosmetics
  • About 80% of the food eaten in the U.S.
FDA’s Role

• FDA oversees company’s strategy and assesses adequacy of recall

• Not all recalls are announced to the media
  • FDA seeks publicity when there is a serious health hazard

• All recalls are published in FDA’s Weekly Enforcement Report according to their classification and with the specific action taken by the recalling company
FDA Recall Classifications

• **Class I Recall:** There is a reasonable probability that the use of, or exposure to, a violative product will cause serious adverse health consequences or death.

• **Class II Recall:** Use of, or exposure to, a violative product may cause temporary or medically reversible adverse health consequences or where the probability of serious adverse health consequences is remote.

• **Class III Recall:** use of, or exposure to, a violative product is not likely to cause adverse health consequences.
Potential Product Recall Costs

- Replacement products
- Repairs to products
- Withdrawing products from stores and distribution centers
- Bodily injury/Property Damage claims
- Lost profits
- Customer service training and dedication and other response expenses
- Notification and advertisement of recall
- Reputational costs
What To Do?

• Attempt to determine the scope of the potentially hazardous defect
  • Are all products impacted?
  • Only products from certain manufacturing locations or produced on certain dates?
• Put all relevant insurers on notice of potential loss
• Work quickly to minimize the impact of the defect
  • Stop the production or sale of impacted products
  • Establish a warning and notification system
Cooperation with Governmental Entities

• Product recalls may require a company to work with governmental entities to ensure a successful recall
  • The FDA, for example, will evaluate whether a company has made all reasonable efforts to remove or correct a hazardous product

• Could face a lawsuit from a governmental entity seeking a mandatory recall if voluntary action is not taken
Product Recall: Disaster or Marketing Opportunity?

• Your company’s response to a recall can make or break your business

• Compare:
  • Intel’s response to consumer complaints of math errors
    vs
  • Saturn’s response to defective seats

• Planning a recall response strategy can avert disaster
Commercial General Liability Coverage
Commercial General Liability

“We will pay those sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’ to which this insurance applies.”

ISO Form CG 00 01 04 13, Section I.1.a
Property Damage

a. *Physical injury* to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. *Loss of use* of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the “occurrence” that caused it.

ISO Form CG 00 01 04 13, Section V.17.
Bodily Injury

"Bodily injury" means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.

ISO Form CG 00 01 04 13, Section V.3.
Other Potentially Covered Damages

• Loss of Use
  • Lost revenue from a plant shutdown
  • Damage to reputation
  • Losses incurred as a result of changes in customer demand

• Consequential damages, including lost profits
  • Potentially covered as damages “because of” property damage.
Lost Profits

• May be covered under CGL policy as damages occurring “because of” property damage.
  • E.g., Ferrell v. W. Bend Mut. Ins. Co., 393 F.3d 786, 795 (8th Cir. 2005) (CGL policy covers lost profits); Reinsurance Ass'n of Minnesota v. Timmer, 641 N.W.2d 302, 314 (Minn. Ct. App. 2002) (lost profits covered as damages flowing from property damage)
Increased Costs

• As with lost profits, may be covered as damages “because of” property damage.
  • E.g., Gibraltar Cas. Co. v. Sargent & Lundry, 214 Ill. App. 3d 768 (Ill. App. Ct. 1990) (increased cost to complete covered under property damage definition including coverage for loss of use)
Common Defenses to Coverage

• Lack of property damage
• Your Product exclusion
• Impaired Property exclusion
• Sistership exclusion
• Pollution exclusion
Lack of Property Damage

- CGL coverage requires property damage to trigger coverage.
- Property damage does not necessarily require actual destruction of property.
- Courts have held there is property damage where defective product was installed or incorporated into an otherwise functioning product if there is a resulting decrease in the value of the product.
  - Property damage occurs on date defective product is incorporated
  - *Hoescht Celanese Corp. v. Certain Underwriters at Lloyd's, London, 673 A.2d 164 (Del. 1996)* ("property damage" occurred as early as installation of defective product into building).
Your Product Exclusion

Bars coverage for:

“Property damage” to “your product” arising out of it or any part of it.

ISO Form CG 00 01 04 13, Section I.2.k
Impaired Property Exclusion

Precludes coverage for:

"Property damage" to "impaired property" or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

ISO Form CG 00 01 04 13, Section I.2.m
Impaired Property Exclusion (con’t)

• Applies only to property that can be restored to use through repair, replacement, or removal or defective component product.

• Does not apply if property has been irreparably damaged or if replacement of the product would not have a restorative effect.

Sistership Exclusion

Precludes coverage for damages associated with the recall of Products, Work or Impaired Property:

Damages claimed for any loss, cost or expense incurred by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of:

(1) "Your product";

(2) "Your work"; or

(3) "Impaired property";

if such product, work, or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or dangerous condition in it.

ISO Form CG 00 01 04 13, Section I.2.n
Risk of Relying on CGL Coverage

- The Sistership Exclusion is intended to preclude coverage for costs related to “preventative or curative action” for the product itself and may wholly preclude coverage if the only costs incurred by the insured relate to the withdrawal of products to allow for corrective measures.
  - E.g. Car dealership discovers defect in a certain model and recalls all other cars of that model to take corrective action.
Limitations on the Sistership Exclusion

- Only applies if there is a recall of your product, your work, or impaired property.
  - Should not apply if your product was only incorporated into the recalled product
- Not intended to preclude coverage for damages caused by the defective product or caused during the removal of the defective product.
- Courts have held that damages resulting from the initial product failure are also not excluded.
- May not apply unless there is a market-wide recall of the product.
- Some versions of the sistership exclusion do not preclude coverage unless it is the insured initiating the recall (generally found in older policies)
Pollution Exclusion

"Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of "pollutants."

ISO Form CG 00 01 04 13, Section I.2.f
Recall Insurance
First Party v. Third Party Coverage

- Third Party: customer’s expenses resulting from recalls involving insured’s products
  - E.g. Diminished value resulting from insured’s defective product being incorporated into third-party’s product

- First Party: insured’s own expenses associated with a product recall
  - Notifying customers
  - Disposing of recalled products
  - Conducting the recall
First-Party Recall Insurance

“[W]e shall reimburse you for product recall expenses resulting directly from a covered incident provided (1) such covered incident takes place in the coverage territory, and (2) the initial oral or written publication of such covered incident takes place during the policy period.”
Third-Party Recall Insurance

“[W]e shall reimburse you for product recall liability damages resulting directly from a covered incident, provided (1) such covered incident takes place in the coverage territory, and (2) the initial oral or written publication of such covered incident takes place during the policy period.”
Covered Incident

“the recall, removal, recovery of possession or control, withdrawal or disposal of, or purposeful destruction of your product(s) from or by a distributor, purchaser, retailer, wholesaler, or user of your product(s) solely because the use or consumption thereof has resulted in bodily injury or property damage, or because the use or consumption thereof poses actual and imminent danger of resulting in bodily injury or property damage.”
Product Recall Expense

- Covered first-party recall expenses:
  - Notifying others of the recall
  - Transporting recalled items
  - Disposal of recalled items
  - Rental fees for additional storage space
  - Administrative costs to utilize personnel to assist with covered incident
  - Overtime wages
  - Personnel transportation and accommodation costs in connection with a covered incident
  - Retail slotting fees and cancellation fees for any advertising or promotional programs which were scheduled but which were unable to be executed because of an insured event
Product Recall Liability Damages

• Covered third-party recall damages:
  • “Any sums that you become legally obligated to pay as compensatory damages.”
    • Sums owed pursuant to contract of indemnity or contract of reimbursement
    • May include business interruption, loss of reputation, lost profits, transportation and labor costs
    • Review policy – may not include liquidated or penalty damages
  • Defense costs
  • The recall policy may exclude coverage for costs incurred to replace the recalled product – check policy endorsements to determine coverage for these costs
Common Exclusions

- Bodily Injury
  - Bars coverage for bodily injury, emotional distress or mental anguish

- Property Damage
  - Bars coverage for “physical injury to or destruction of tangible property other than your product.”
Other Noteworthy Exclusions

• There may be exclusions specific to products that are topical or ingestible

• First- and Third-Party Exclusions:
  • Arising out of any pre-existing condition that insured knew of or reasonably should have known of prior to inception of policy
  • Intentional acts or omissions that could reasonably be expected to lead to a covered incident
Exclusions
con’t

• First-Party Only Exclusions:
  • Damages associated with a decrease in product sales after publication of a recall
    • Damages associated with “adverse publicity” arising from the recall
  • Costs to repair or decontaminate products to render products marketable
  • Arising out of the recall of a similar product by a competitor
  • Costs to redesign or recalibrate product
  • A recall arising out of the natural gradual deterioration, decomposition or transformation of the chemical structure of a product.
Duties of the Insured

• Provide notice as soon as practicable
  • Some policies have very specific notice requirements, including the requirement to notify a crisis hotline

• Cooperate in the investigation, settlement or defense of the claim

• Provide a sworn proof of loss
Other CGL and Recall Insurance Provisions

• Limits of Liability
  • Product recall expenses and product recall liability may have separate limits

• Coinsurance

• Self-insured retentions
  • Must be satisfied before coverage applies
  • Likely have separate self-insured retentions for first–party and third-party recall insurance
Key Responsibilities

- Responsible for the leadership, vision, strategy and execution of the risk transfer programs.
- Responsible for claims management oversight, ensuring contractual obligations and performance is to standard or better.
- Provide proper financial protection measures through risk identification, risk avoidance and risk transfer/retention programs.
- Responsible for the selection, submission, negotiation of risk finance and insurance vendor services.
- Develop objective measurements of performance for risk management providers.
- Lead ERM due diligence process for all M&A and greenfield projects.

EXPERIENCE: over 20 yrs. in Risk Finance and Insurance

PRIOR COMPANIES
- ARAMARK Corporation, Philadelphia PA
- Campbell Soup Company, Camden NJ
- Marsh Inc., Philadelphia PA
- Saint-Gobain Corporation, Valley Forge PA

EDUCATION
- MBA, Finance, Temple University, Philadelphia, PA
- B.A., Villanova University, Villanova, PA

Present & Past Associations/Technical Committees & Affiliations
- Risk & Insurance Mgmt. Society (RIMS)
- Manufacturers’ Alliance Insurance Group (MAPI)
- Watermark
- ACE Insurance Advisory Council
- Risk Sciences Group Advisory Counsel
- Women’s Food Service Forum
Joann Lytle helps corporate policyholders maximize their insurance assets and has recovered hundreds of millions of dollars for a wide range of companies, including those in the food services, manufacturing and health care industries. She has handled disputes involving commercial general liability, umbrella liability, errors and omissions liability, directors and officers liability, employment practices liability and cyber liability policies. In addition to representing policyholders in coverage disputes, Joann also provides insurance coverage advice and counseling to her clients on an ongoing basis. She graduated *maxima cum laude* from LaSalle University in 1987 and obtained her J.D., *cum laude*, from Harvard Law School in 1990. Business Insurance Magazine recognized Joann as one of its 2014 “Women to Watch.” In 2014, she was recognized by *Chambers USA* as a “Leader in Their Field.” Joann was selected as the exclusive Pennsylvania winner of the Lexology Client Choice Award in 2013 and 2014. Joann has also been recognized in *Best Lawyers in America* since 2008.
Please complete the session survey on the RIMS15 mobile application.