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COVERAGE FOR PRODUCT RECALL EXPOSURES

By Mary Beth Sipos

Beyond the potential liability for bodily injury caused by defective consumer goods, medicine, or foodstuff, the expense of a product recall can be considerable. The author of this article discusses insurance coverage for product recalls and why the expense of product recalls should be part of any fully considered risk management and insurance program.

What do seven tons of hummus have in common with 29 million GM vehicles? They both recently have been withdrawn from the marketplace by their manufacturers' voluntary product recalls.

Within recent weeks, GM announced the recall of eight million vehicles for ignition switch defects, bringing the total number of cars it has recalled this year to 29 million, at a projected expense of \$1.2 billion, according to *The Wall Street Journal*.

But corporate giants like GM are not the only companies that face exposure to recall. A regional food producer under contract to Trader Joe's had to recall seven tons of hummus recently for fear of listeria contamination. How does one go about recalling seven tons of hummus and disposing of it? How much can such a recall cost and, perhaps most importantly, who pays for it?

Product Recalls

Anticipating the risk and understanding the availability and extent of insurance coverage for product recall is best accomplished long before a recall happens. Any manufacturer, distributor, retailer, and especially importer, of goods of all sorts may eventually face a recall of defective, contaminated, or dangerous products. Having insurance funds available for a prompt response to potential product defects or food contamination makes it much easier to announce and effectuate a recall. That can make the difference between an expensive inconvenience and a major liability exposure that could put a company out of business.

Virtually any product defect or contamination or even mislabeling can lead to a recall; either a voluntary recall initiated by the insured or a recall legally mandated by a regulatory agency.

It is not unusual for an insured to recall defective or contaminated goods on its own initiative. A voluntary recall may prevent further injuries and exposure to greater liability for a known defect. It also can be used to test and repair or confirm the safety of a product for return to the consumer.

In addition, numerous government agencies sharing responsibility for public health and safety in connection with food and other goods may order recalls for a wide range of goods from the simplest to the most sophisticated. For example, the Consumer Products Safety Commission regulates products that pose a fire, electrical, chemical or mechanical hazard, so its reach extends from toys to power tools. The Food & Drug Administration is primarily responsible for the safety of medicine, but also oversees cosmetics and dietary supplements. The U.S. Department of Agriculture's food contamination cases have grabbed headlines with major outbreaks of illness and death caused by contaminated cantaloupes, peanut butter, lettuce, and salsa.

The Costs Associated With Product Recalls

In either context, whether voluntary or mandated, the mechanics of a recall can make it very expensive. The chief objectives are to communicate the hazard and availability of corrective action to the public, locate the defective products quickly, and remove them from the open market. Accordingly, communication, transportation, and repair or disposal and destruction expenses are all involved. The costs may include:

- media expenses announcing the recall;
- the cost of locating, transporting, and destroying or disposing of goods;

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- rental of additional storage space;
 - retail slotting fees and cancellation fees;
 - overtime and additional employee expense to handle the recall;
 - costs of cleaning the insured's own equipment and physical plant if contaminated; and/or
 - the costs of redistributing rehabilitated product or replacement product.

Understanding what kind of coverage is available for such expenses and when exclusions eliminate coverage can help identify the type and amount of insurance coverage needed.

Insurance Coverage for Product Recalls

Most standard liability policies actually exclude coverage for recall expenses via a recall exclusion traditionally known as the "sistership" exclusion. It "operates to exclude coverage for the cost of 'preventative or curative action' when the insured withdraws a product in situations in which a danger is merely apprehended."¹ "It does not, however, operate to exclude coverage for actual damage caused by the very product giving rise to such an apprehension."² In other words, the costs of preventing property damage or bodily injury by conducting a recall are not covered. However, the exclusion will not apply to damages actually caused by the product, before or after recall.

Thus, distinguishing between the expense of an actual recall of all products, defective or not, and the damage claims associated with injury caused by defective goods is important. In the latter case, there may be coverage or at least a duty to defend the insured, depending on the policy language. In *Centillum Communications, Inc. v. Atlantic Mut. Ins. Co.*,³ for example, ambiguity in the phrase "public notice recall" and evidence that the insured's recall was not a mere "preventative measure," meant it was entitled to a defense of suits against it for defective routers.

What is a "Recall" for Coverage Purposes?

Coverage for the expense of a product recall can be covered in a number of ways. It is not uncommon for carriers to make such coverage available by endorsement to a general liability policy or as part of stand-alone coverage for product liability. In either event, the extent of coverage afforded by a particular product depends on the definition of the term "recall." Since there is a broad range of possible recalls, from the formal order of a government agency following litigation to a prophylactic recall by a manufacturer to test and determine if there is any contamination at all, comparing the facts to the policy language is vital.

In some cases, neither the insuring form nor the endorsement define the terms "recall" as anything more than a "withdrawal." Using the rule of "plain language" construction, the term "withdrawal" is ordinarily and generally understood to mean "remove; ... a removal of from a place or position of something deposited[.]"⁴ The issue is often the stage at which products are recalled. According to one commentator, "[w]ithdrawn from the market' clearly means 'recalled before sale'— i.e., removed from wholesalers' or retailers' shelves. 'Withdrawn from use,' as a parallel provision, must then mean 'recalled after sale'— reclaimed from purchasers."⁵ Thus, in one example, a policy may liberally extend coverage to expense incurred and reported for withdrawal of the insured's products, "provided that: . . . such withdrawal is required because of a determination by you during the policy period, that the use or consumption of your products *could* result in 'bodily injury' or 'property damage,'" leaving the determination to the insured and therefore including coverage for voluntary withdrawals. Other, narrower endorsements may specifically require an official government mandate to constitute a recall.⁶

A policy form specifically providing product contamination coverage may provide recall coverage for recall of a product known to be defective and also for "expenses related to chemical analysis in order to ascertain whether insured's 'products' have been contaminated and/or to ascertain the potential effect of the 'accidental product contamination.'" Even then, if post-recall testing established the absence of contamination, there may be no coverage.⁷ Thus, from a risk management perspective, knowing the extent of the risk to be covered and matching it to the insurance coverage that best meets that range of exposures is paramount.

Recall Notification Expense Coverage

Even where there is no doubt that the insured is involved in a recall, determining the extent of the policy benefit also is complicated. For example, one carrier sells an endorsement that provides coverage for, "notification expenses" and defines that the term to

include, “the reasonable additional expenses (including, but not limited to, cost of correspondence, newspaper and magazine advertising, radio or television announcements and transportation cost), necessarily incurred in arranging for the return of products, but excluding costs of the replacement products and the cash value of the damaged products.” In one reported case, the endorsement specified that overtime labor and retention of additional employees were also covered expenses.⁸

A product contamination policy may specifically include the cost of “chemical analysis in order to ascertain whether the Named Insured’s PRODUCT(S) have been contaminated” as a component of recall expense. Even then, coverage may be limited. In *Little Lady Foods, Inc. v. Houston Cas. Co.*,⁹ the court held there was no coverage for the expense of a recall incurred by a burrito manufacturer after an error in processing required product recall for testing for harmful bacteria. Since the testing revealed no contamination the policy terms were not met and the coverage could not be extended to include every expense associated with quality control.

Conclusion

The time to assess potential exposure to product recall expense and review the available coverage is before a recall happens. Factors like the volume and variety of goods and products an insured sells, manufactures or even merely handles, the domestic or foreign source of them, and the degree of control the insured exercises over quality control all effect this risk. Beyond the potential liability for bodily injury caused by defective consumer goods, medicine or foodstuff, the expense of a recall can be enormous and should be part of any fully considered risk management and insurance program.

Endnotes

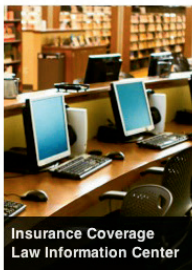
1. *Armstrong World Indus. v. Aetna Cas. & Sur. Co.*, 45 Cal. App.4th 1, 113, 52 Cal.Rptr.2d 690 (Cal.Ct.App.1996).
2. *Id.* (emphasis added). See also, *Hi-Port, Inc. v. American Intern. Specialty Lines Ins. Co.*, 22 F.Supp.2d 596 (S.D.Tex., 1997).
3. 528 F.Supp.2d 940 (N.D.Cal. 2007).
4. *The American Heritage Dictionary*, Second College Edition, p. 1387.
5. J. Gibson & M.McLendon, *Commercial Liability Insurance*, Sec. V., International Risk Management Institute (May 2005), available at <http://www.irmi-online.com>.
6. See, *Caudill Seed & Warehouse Co., Inc. v. Houston Cas. Co.*, 835 F.Supp.2d 329, 337 (W.D.Ky., 2011). [emphasis added].
7. See e.g., *The Limited, Inc. v. Cigna Ins. Co.*, 228 F. Supp. 2d 574, 576 (E.D.Pa. 2001) [no coverage for recall by insured retailer of aerosol-dispensed foam body wash where it failed to demonstrate that product was adulterated and recall was based only on the malfunctioning dispenser].
8. See e.g., *Atlantic Mut. Ins. Co. v. Hillside Bottling Co., Inc.*, 387 N.J.Super. 224, 903 A.2d 513 (2006) [“The following necessary and reasonable expenses you incur exclusively for the purpose of recalling ‘your product’: . . . (3) For remuneration paid to your regular ‘employees’ for necessary overtime; (4) For hiring additional persons, other than your regular ‘employees.’”].
9. 819 F.Supp.2d 759, 760 (N.D.Ill., 2011).

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