Insurance for Product Withdrawal

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IN ANY DISCUSSION OF THE PROBLEMS presented by the withdrawal of defective or potentially defective products from the marketplace, it is important to consider the subject of insurance. While insurance protection against product withdrawal can insulate a manufacturer against some of the costs associated with a withdrawal program, insurance itself may be one of the factors which makes the institution of such a program necessary.

The fact that one or more of a manufacturer's products may have reached a retailer or consumer in a defective or dangerous condition gives rise to a potential for customer ill will, damage to the manufacturer's reputation and the specter of a products liability lawsuit. The purpose of this paper is not to discuss products liability litigation. However, the potential for a products lawsuit or lawsuits is one of the factors which makes product withdrawal essential.

When a manufacturer receives notice that his product has caused, or is alleged to have caused, injury or damage to a consumer, it would be relatively easy to assume the attitude that this is a problem for his liability insurer to worry about. After all, the manufacturer spends a substantial amount of money each year for liability insurance. Claims and potential lawsuits are what the insurance company is in the business of handling. The manufacturer might easily take such a position but for two important considerations.

The first, and most obvious, condition militating against taking such a position is the natural concern that a reputable manufacturer has in preserving the quality reputation of its product line. A "buyer be damned" attitude would certainly tarnish the corporate and product image and reputation.

A second consideration, not as obvious but equally if not more important than the first, is the peril in which such a position may place the manufacturer with relation to its products liability insurance coverage.

Product Withdrawal Program

Substantial revisions were made in the Comprehensive General Liability Policy (CGL) in 1966. For the purpose of our discussion two provisions of the new policy form are very important. The policy clearly spells out the obligation of the insured-manufacturer in case of bodily injury or property damage covered by the policy. It provides that:

> The named insured shall promptly take *at his expense* all reasonable steps to prevent other bodily injury or property damage arising out of the same or similar conditions, but such expense shall not be recoverable under the policy.

An example may be in order to illustrate how this policy condition may cause a need for a product withdrawal program. Assume Company A produces canned fruit. It learns that a person who ate some of the canned fruit becomes seriously ill and that the condition was traced to a foreign substance in the can. It notifies its liability insurer of the potential of a products liability claim but takes no other action. Within a week it receives more notices of illness to other persons who had eaten canned fruit from the same batch. It notifies its liability insurer of the possibility of other claims. The insurer investigates the company's activities after notice of the first illness. The insurer then notifies the fruit packer that it will not defend or pay any of the subsequent claims because the fruit packer violated the policy condition requiring it to take reasonable steps to prevent other bodily injury arising out of the same or similar conditions.

It may be seen from this example that the failure to institute a withdrawal program by the fruit packer places it in the position of being exposed to the possibility of a number of liability claims which would have been covered by its liability policy had it complied with the policy conditions. However, because it did not comply with the conditions of the policy, it must now go to the expense of defending the claims itself. Should the claimants prevail, it could be exposed to substantial judgments which must be paid from its own assets.

It should be noted that the insurance policy provision is quite explicit in stating that any steps that will be taken by the insured to prevent other bodily injury or property damage shall be at the insured's own expense and that the expense will not be covered by the policy.

To make it even more clear that the Comprehensive General Liability Policy would not provide reimbursement to the insured for a products withdrawal program, the underwriters added Exclusion (n) or the so-called "Sistership Exclusion" to the policy. It provides that the insurance coverage of the policy does not apply:

> (n) to damages claimed for the withdrawal, inspection, repair, replacement, or loss of use of the named insured's products . . . if such products, work or property are withdrawn from the market or from use because of any known or suspected defect or deficiency therein;

This clause makes it abundantly clear, if it was not before, that the insurer under a Comprehensive General Liability Policy will not foot the bill for a product withdrawal—even though it may obligate the insured to institute such a process in order to preserve its protection against liability afforded by the CGL.

Product Withdrawal Coverage

The manufacturer, considering the possible exposure to a product suit in the event that a product may prove to be defective, has a rather clear-cut decision to make. Viewing the nature of his product, he must determine if a defect in a product may give rise to the need for a withdrawal program. Quite naturally, products produced in batches such as food, have a greater potential for a withdrawal program in case of defect than do products where a defect is most likely confined to only one unit. When the potential that a large number of the same product may be defective is high, the need to consider the possibility of securing product withdrawal coverage becomes imperative.

Interest in Insurance Coverage Increased

Although product withdrawal insurance has been offered for only about five years, manufacturers' interest in the coverage has been sharply accelerated since the now famous Bon Vivant Soup case.

What Is Covered

We must first consider what protection an insurance company will afford under product withdrawal coverage. The policy provides that the insured will be indemnified for expenses paid by the insured for the withdrawal made necessary by reason of the insured's decision or ruling of any governmental body that the use or consumption of a product will result in bodily injury, sickness, disease or death solely because of error or inadvertent omission in the manufacture or labeling of the product.

Note should be taken of the fact that the decision to withdraw the product can be made either by the manufacturer or by a governmental agency. There is no requirement that injury, illness or death has occurred before the withdrawal is begun.

The policy, by defining the word "expenses," makes it clear just what items of expenditure in a withdrawal campaign will be reimbursed. They are listed as the reasonable and necessary costs of:

(1) telephone and telegraphic communications, radio or television announcements, newspaper advertising;

(2) stationery, envelopes, production of announcements and postage therefore;

(3) remuneration paid to regular employees of the named insured for necessary overtime;

(4) the cost of hiring persons other than regular employees of the insured or his agents;

(5) the actual cost of disposal of the products; but only to the extent that it is determined by the insured that specific methods of destruction other than those usually employed for trash discarding or disposal are required to avoid bodily injury, sickness or disease or death as a result of such disposal.

You will note that the coverage is limited. The actual expenses of notices to wholesalers and retailers will be paid. The cost of media ads and announcements will be reimbursed. However, only overtime pay to regular employees to get out notices, ads and announcements will be covered. Note also that disposal of the product may be covered, but nothing is mentioned about the cost of returning the product to the manufacturer's plant. This is why it is not technically correct to refer to the coverage as "recall" insurance since only *withdrawal* is covered.

What Is Not Covered

The policy spells out the fact that it will not provide coverage for the withdrawal of products by reason of the following:

(1) Failure of the product to accomplish its intended purpose;

(2) Improper, inadequate or faulty formulae or specifications;

(3) Breach of warranties of fitness, quality, efficacy or efficiency;

(4) Deterioration, decomposition or transformation of chemical structures unless a result of error or omission in the manufacture of the product;

(5) Their being kindred products of the insured;

(6) Their being of the same trade or brand name but of different batches than that which has been determined to possibly be likely to cause a loss (if the insured represented when the policy was taken out that the products are identifiable by batch);

(7) Loss of consumer faith or approbation, or any costs incurred to regain customer approval, or any other consequential damages;

(8) Redistribution or replacement of the withdrawn product by like products or substitutes;

(9) Caprice or whim of the insured; or

(10) Prior knowledge of the insured at the inception of the policy of any pre-existing condition of the products possibly or likely to become a cause of loss under the policy.

It is clear from the exclusions that the coverage is intended to cover only a limited series of events. There is no coverage for conditions which arise due to defects which may be traced to errors in the design or formula stage of production as opposed to an error by a workman charged with the actual manufacture of the product. A withdrawal of a weed control compound would not be covered if an error in developing its formula makes it ineffective in controlling weeds. However, if a workman made an error in mixing the compounds that went into the product and this led to crops being killed along with weeds, the insurance would cover the withdrawal.

If batches of the product can be identified and only one batch is defective, the withdrawal coverage will only apply to the removal of the defective batch from the market even though, for some reason, other batches are also removed.

In addition, the loss of consumer faith in the product, expenses incurred to regain that faith and replacement of the defective product with non-defective products will not be covered.

Thus, the sole purpose of withdrawal coverage, as seen by insurers, is to remove the threat of potentially dangerous products from the marketplace.

Limitations on Liability

The product withdrawal policy provides limits on the liability of the insurer for those expenses that are covered. First withdrawal coverage is written subject to a deductible. A deductible provision merely means that the insured assumes some agreed upon portion of the loss before the insurer is obligated to pay any sum under the policy. You are all familiar with the $50 or $100 deductible provisions of automobile collision coverages. The most common deductible written with products withdrawal coverage is $5,000. This means the manufacturer must itself bear the first $5,000 of the cost of the withdrawal program. Lower deductible amounts are written, but a lower deductible means a higher total premium for the coverage.

The second limitation written into the policy is the provision that the insurance company will be liable for only 80% of the amount of covered withdrawal expenses above the amount of the deductible. The manufacturer becomes a co-insurer for 20% of each occurrence.

The purpose of these two provisions is clear. If the deductible and 80% provision were not used, the insured would be handed a blank check for its withdrawal program. However, if the insured bears a portion of the expense, it is more likely to use reasonable restraint in the withdrawal campaign.

Premiums for Coverage

Premiums for product withdrawal coverage are, of course, dependent on the nature and number of products covered, and the potential withdrawal program which may be necessary in case of a product defect. Quite naturally, a manufacturer producing only one product with distribution limited to a small territory will pay less for the coverage than would a manufacturer with a large product line distributed over the entire country. The policy also provides for adjustment of the premium at the end of the policy period to reflect actual exposure, i.e. retroactive rating.

Very few insurers offer product withdrawal coverage. Most of them provide it to their insureds who also buy other forms of insurance, such as general liability coverage, workmen's compensation, etc. However, it may be expected that as the demand for this coverage increases, the market from which it is available will also increase.

Product withdrawal coverage is relatively new when compared to other forms of insurance which have been written for many years. However, the policy is very simple and clear-cut when compared to other policy forms. It was developed because of an obvious need. We live in an era in which technology has placed and will continue to place many new products into the marketplace. Unfortunately, quality control procedures, as sophisticated as they have become, do not provide total assurance that defective products will not reach consumers. The human element always enters into the picture. As long as there is a potential for defective products there will continue to be a need for the manufacturer to protect itself against the contingencies that will result. Liability insurance against product liability claims is one answer to the problem, but not a complete answer.

Recent events have shown the financial disaster that faces a company that is not prepared to meet the enormous burdens which arise from the need for a full-blown product withdrawal campaign. To its credit, the insurance industry has devised a means by which a prudent manufacturer can relieve itself of these burdens.

No matter what insurance programs are available, however, manufacturers must constantly strive to eliminate the potential for product defects. This is the only sure means to mitigate the problems inherent in product withdrawal. **[The End]**