Product Recall Coverage versus Product Recall Expense Coverage

The recall of your products from the marketplace, whether voluntary or mandated, will undoubtedly cause tremendous impacts on your business both internally and externally. Your organization's capacity to respond quickly and effectively to minimize the impacts to the future solvency of the organization is paramount. A comprehensive Product Recall Plan is the most useful tool in the event of a recall, but this article will focus on the backstop to the plan, your insurance coverage.

There are numerous exclusions present on a typical Commercial Package Policy to preclude the insured's recovery in the event of a loss due to impaired products. Commercial General Liability (CGL) policies will typically respond to any resultant bodily injury or property damage, but the financial injuries, both first and third party, and other related expenses do not trigger coverage.

In order to close the coverage gap, the company must purchase some level of product recall coverage. Typically a broker or underwriter will recommend the ISO CG 04 36 Limited Product Withdrawal Expense Endorsement, or its equivalent, to "close" the gap. In reality the gap is still wide open and the insured remains highly exposed.

The CG 04 36 offers very limited coverage, as indicated in its name, for <u>expenses</u> related to a necessary recall. Coverage is typically sub-limited much lower than the per occurrence limit, and only eight defined "Product withdrawal expenses" are eligible for coverage. The eight eligible expenses as defined by the endorsement are:

a) Costs of notification;
b) Costs of stationary, envelopes, production of announcements and postage or facsimiles;
c) Costs of overtime paid to your regular non-salaried employees and costs incurred by your employees, including the costs of transportation and accommodations;
d) Costs of computer time;
e) Costs of hiring independent contractors and other temporary employees;
f) Costs of transportation, shipping or packaging;
g) Costs of warehouse or storage space; or
h) Costs of proper disposal of "your products" or products that contain "your products" that cannot be reused, not exceeding your purchase price or your cost to produce the products.

These specified causes of loss are eligible for recovery to the limit stated on the endorsement for claims occurring within the coverage territory.

What is most notable on the CG 04 36 endorsement, is what is not contemplated for coverage. Beyond what are likely inadequate limits of coverage, a number of exposures are not contained within the eight eligible expenses defined in the endorsement.

In contrast to CG 04 36, true Product Recall policies will provide coverage, at higher limits, for additional exposures a manufacturer will face in the event of a recall. The policy will likely contemplate coverage for pre-recall expenses, recall expenses, third party recall expenses, loss of gross profit, rehabilitation expenses, increased cost of working expenses, governmental fines and penalties or a product extortion demand.

Often there are many unanticipated expenses associated with a recall. Liabilities that are transferred to the manufacturer by third parties, i.e.:

a) Manufacturers
b) Customers
c) Co-packers
d) Retailers
e) Distributors
f) Other entity in the chain of manufacture, distribution, handling or sale of contaminated products
g) Does not include ultimate end user

These expenses are often transferred to the manufacturer in the contracts or purchase orders by the third party. Often, the manufacturer is not aware that it has retained this exposure until the time of loss.

Product Recall policies provide significantly broader coverage grants than the Product Withdrawal Expense Endorsement, but also comes at a much higher premium. Like all areas of risk, every company must determine which, if any, coverage is most appropriate for its operation.

Product recall policies will, more than likely, respond to losses occurring worldwide. Also will provide crisis management consultants to assist the policy holder that is anticipating, or involved in, a loss.

Seeking outside advice from a TCOR™ Certified Analytical Insurance Broker or risk advisor will help provide insight as to ultimate loss exposure. Review of contracts, purchase orders, and product recall plan and procedure will allow the organization to make a prudent decision on how best to spend its insurance dollars, and the most appropriate deductible structure to keep costs within budget.

Product recall incident trends are rising due to shifting regulations and emerging testing technologies. Related product recall expenses are also rising as technology has allowed notification to end users outpace the purge rate of product in the marketplace.

Prudent forethought and risk management techniques can minimize the impacts of an unanticipated recall event unanticipated, the immediate response of your risk management plan should be quite deliberate and rehearsed.

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