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Total Recall:
The Ins and Outs of Coverage for Product Recalls and Chipotle-Like Incidents

Jes Alexander

Tamara D. Bruno

TOTAL RECALL:
THE INS AND OUTS OF COVERAGE FOR PRODUCT RECALLS AND CHIPOTLE-LIKE INCIDENTS[1]

Blue Bell and listeria – shutdown of ice cream production for months. Samsung and exploding phones – recall of a million phones in the United States alone. Takata and deficient airbags – over 35 million cars recalled. The list of companies experiencing food and product recalls in the past few years goes on and on.

For anyone following the news, it feels like product and food recalls are at an all-time high. And that feeling is borne out by the facts. In 2015, auto recalls in the U.S. set a record at 51 million.[2] A total of 626 food recalls occurred in 2015, including recalls of a whopping 8,294 pounds of ground beef patties.[3]

When staring such potential disasters in the face, companies will often initiate voluntary recalls, with Bluebell's listeria outbreak as a prime example. In fact, the majority of product recalls are initiated by the company itself. However, when companies are not quick to act, the FDA can and does mandate recall in some circumstances, such as for medical drugs/devices, cosmetics and nearly all food products for humans and animals.

Companies dealing with a product recall are taking fire from all sides. Sales are typically tanking, and the FDA, state and local government entities may begin civil and even criminal investigations. For example, Chipotle is currently facing a criminal investigation in connection with its listeria outbreak.[4] And although criminal prosecutions are relatively rare, the threat of prosecution serves as a powerful deterrent to companies considering delaying a recall.

Once a company decides to initiate a product recall, the costs of that process quickly mount. Such costs may include:

1. Replacement or repair of products (*i.e.*, Samsung providing new phones to all of its Galaxy Note customers);
2. Notification and advertising costs relating to the recall;

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[1] The authors of this paper are Tamara D. Bruno and Jes Alexander. Tamara is a Senior Associate at Pillsbury Winthrop Shaw Pittman LLP, where she represents and advises companies and institutional policyholders in complex insurance recovery matters. Jes Alexander is a Research Analyst at International Risk Management Inc. ("IRMI"). Prior to joining IRMI, he served as deputy general counsel at Dickey's Barbecue Restaurants, Inc. The views reflected in this article are not necessarily the views of the authors or their respective organizations.

[2] Mike Spector, *U.S. Auto Recalls Last Year Set Record at 51 Million*, (Jan. 21, 2016), http://www.wsj.com/articles/u-s-auto-recalls-last-year-set-record-at-51-million-1453406237.

[3] Tiffany Maberry, *A Look Back at 2015 Food Recalls*, (Jan. 19, 2016), http://www.foodsafetymagazine.com/enewsletter/a-look-back-at-2015-food-recalls/.

[4] Hayley Peterson, *Chipotle's E. coli outbreak is getting even more fishy* (Feb. 2, 2016), http://www.businessinsider.com/chipotle-federal-criminal-investigation-subpoena-2016-2.

3. Costs to withdraw products from the stream of commerce, including storage costs and costs to destroy the products;

4. Lost profits;

5. Costs directly relating to the recall process, such as training employees to respond;

6. Damage to the company's brand and goodwill;

7. Lawsuits brought by governmental entities if the company does not institute a recall;

8. Possible retail slotting fees or cancellation fees with merchants due to the recall; and

9. Claims for bodily injury and property damage suffered by some consumers as a result of the defective product.

A natural place for companies to look for recovery of some or all of these losses and costs is to their insurance policies. This paper provides an overview of coverage for product recall and similar incidents under policies specifically written to cover product recalls and under other insurance policies.

I.
PRODUCT RECALL POLICIES TO THE RESCUE

In the past, companies would usually absorb the costs of a recall, deeming them a business cost. However, the costs of recalls have grown in magnitude. Now, the expenses involved in recalls can be the death-knell for a company.

Enter product recall insurance policies, a still-emerging line of coverage. Insureds usually obtain product recall insurance via a specialized stand-alone policy or an endorsement to a CGL or Businessowners policy.[5] Generally, a stand-alone product recall policy is comprised of first party coverage (*i.e.*, reimbursement for expenses directly incurred by the insured) and third party coverage (*i.e.*, coverage for third party losses). Each of these two coverages will be analyzed separately below.

A. First Party Coverages for Recalls

For most insureds, first party coverage is the most important aspect of a product recall policy. This coverage reimburses the business for the costs associated with a recall. These costs include

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[5] The endorsement to the CGL or Businessowners policy is often called Product Withdrawal Expense coverage. As would be expected, the stand-alone product recall policy contains much more comprehensive coverage than Product Withdrawal expense coverage. An insured should carefully consider whether a more limited recall coverage could leave them exposed to massive liability in the event of a recall. However, the focus on this paper will be on the broader stand-alone product recall coverage.

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