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Characteristics of recall insurance

1. INTRODUCTION

The increasing number of product recalls constitutes a challenge for the producing industry. The recall of products often causes damages running into millions.

Companies may compensate damages to persons and to property resulting from defective products by employer's liability insurance or product liability insurance. These insurances do though not cover pure financial loss resulting from product recalls. The industry is interested in covering these risks. To cover these risks, companies can conclude a recall insurance. This article deals with the particularities of this kind of insurance.

2. FUNCTION OF RECALL INSURANCE

Recall insurance shall cover the financial risk of product recalls. Therefore, it covers financial losses which occur when detected or assumed defects require the recall of a product.

2.1 Subject of the insurance cover

The insurance covers financial loss. The reimbursement of injuries to persons or property damages is not insured.

The recall must aim at the avoidance of injuries to persons. The recall insurance does not provide insurance cover if the policy holder recalls solely to avoid property damages.

If, for example, the producer of washing machines recalls its machines for the danger of leaking water from a connecting tube to avoid moisture damages, the recall insurance provides no cover, because the recall only aims at the avoidance of property damages (e.g. buidling damages)¹.

If there was any probability of a fire of the machine and as such a danger for persons, insurance cover would be granted.

¹ Example taken from Veith/Gräfe, Der Versicherungsprozess, sec. 14, No. 299

2.2 The term „recall“

An insured event in recall insurance requires a recall. A recall is the policy holder's or the appropriate authority's request, based on legal duties, to the consumer to examine the products delivered with regard to defects and to provide for the repair of detected defaults.

If, for example, the producer of electronic devices delivers a toaster with an insufficiently insulated power cable, the producer could ask the consumer to send back the toaster to repair the defect that poses a risk to health (recall).

2.3 Duty to recall

The recall has to be based on a legal duty. Otherwise, there is no insurance cover.

The legal duty to recall can result from the duty of surveillance or from official order.

2.3.1 Recall obligation resulting from duty of surveillance

The duty to recall can result from the producer's duty of surveillance. Producers must comply with the legal duty to maintain safety. This duty includes that products placed on the market are monitored for defaults and errors after delivery. If it is identifiable that the products hold any risks for health or life of the consumer, the producers must take preventive action. They have to take measures to prevent harm. If for this it is not sufficient to give simple hints to the consumers, the recall of dangerous products might become necessary. According to the prevailing opinion, these recalls are in accordance with the legal recall duty in terms of recall insurance.

2.3.2 Recall duty by official order

A recall duty may also result from an official order. If a producer places a product on the market, which usage may endanger the consumer's safety or health, the authorities in charge may order a recall. The enabling clause for the recall results from the Product Safety Act. A recall based on official order initiates the insured event in recall insurance.

2.4 Time scope of insurance cover

The insurance cover for financial loss resulting from recalls has the following time scope.

2.4.1 Time limitation of the cover

The cover exists solely for those recalls declared during the insurance period. If the recall happens after the termination of the insurance contract due to defect products delivered during the insurance period, there is no insurance cover.

Also, recall insurance covers only those recalls which occur within a period of three years after delivery of the policy holder's products.

If the producer has for example concluded a recall insurance for the period from 1st January 2012 until 31st December 2017 and delivers a defect and dangerous product on 1st January 2012, there would be no insurance cover for a recall performed on 1st January 2017. The insurance contract still exists at the time of the recall, but more than three years have passed since the delivery of the product.

2.4.2 No cover for prior damages

The insurance cover is also limited by the exclusion of damages which occur prior to delivery. According to the insurance terms, claims resulting from costs in connection with products which have not yet been delivered to the consumer are not covered by the insurance.

If, as in the example above (2.2), the producer of the toaster discovered the defective power cable prior to the delivery and took measures to avoid harm, the relating financial damages (costs for the exchange) are not covered by the insurance. These prior damages are excluded from insurance cover since the danger to the consumer's health, required for recall insurance, is not yet given. Financial damages to the policy holder that arise before the recall of the product must therefore not be reimbursed by the insurer.

2.5 Scope of insurance cover

The insurance terms finally regulate the scope of the insurance cover. The insurer does not have to reimburse cost positions which are not listed in the insurance terms to the policy holder who is subject to the recall. The exclusive list of insured cost positions has the function to distinguish between the employer's liability insurance and the product liability insurance. Double insurance is avoided.

With regard to recall insurance, policy holders are regularly entitled to reimbursement of the following costs.

2.5.1 Notification costs

The insurance covers notification costs caused by the product recall. Notification costs are costs to inform consumers about the products' dangerousness. These costs include costs for media appeals (among others on radio and TV, in the media and on the internet).

2.5.2 Return transport costs

The costs for the transport of the products from the consumer to the policy holder for examination and rework are covered. These transport costs are often high, as the products are regularly widespread among many consumers.

The re-transport of the reworked products to the customers is though not insured.

2.5.3 Costs of examination

The costs for the examination of recalled products are covered by insurance. Often, not every recalled product is defective. Therefore, an examination of the product before rework is necessary. The hereby arising costs (examination costs) are reimbursed by the insurer.

2.5.4 Interim storage costs

The insurer reimburses the interim storage costs resulting from the recall of products, if the policy holder's storage capacities are not sufficient.

The policy holder's storage capacity is usually not sufficient for all recalled products. In this case, the producer is forced to rent additional storage space during the process of examination and rework.

The reimbursement of interim storage costs is limited to a period of no more than three months.

2.5.5 Exchange costs

Often, defective products are combined with other products in a multi-stage process. To eliminate the danger, it is necessary to remove the defective part from the overall product. The costs for this reconstruction and the following assembly of the repaired part are covered by insurance.

If, as in the example above (2.2), the policy holder delivers an insufficiently insulated power cable, which another producer combines with the toaster body, this signifies such a combination. The exchange of the power cable is insured.

2.6 Exclusions

The scope of the insurance cover in recall insurance is broad. Still insurers define the usual exclusions in insurance terms, which exclude insurance cover a priori.

2.6.1 Testing clause

Damages resulting from the recall of products which were, according to the state of the art of science and technique or in another way insufficiently tested, are not insured. Insurers often use the exclusion fact of an insufficient testing and refuse cover. They sometimes exaggerate the requirements for a sufficient testing by demanding continuing laboratory examination as testing. It is though a question of the individual case what can be regarded as sufficient testing in the sense of the testing clause. Often, laboratory testing is not necessary.

2.6.2 Guarantees

If the policy holder is obliged to recall a product due to given guarantees, there is no insurance cover.

If a recall is required solely due to a guarantee, there is no risk for the consumers' health. The exclusion of insurance cover for guarantees thus indicates a matter of course.

If there is, independent of the guarantees given, a legal duty to recall due to the danger of injuries to persons, insurance cover exists.

2.6.3 Manipulation damages

Damages from recalls due to claimed, threatened or actually willful and malicious manipulations of products are not insured. If, for example, a recall becomes necessary because criminals threaten to poison food produced by the policy holder, insurance cover from the recall insurance is excluded.

The policy holder could agree on special cover concepts such as the product protection insurance.

3. CONCLUSION

Recalls are mandatory for producers to avoid liability.

Recalls regularly cause high costs which might lead to a company's insolvency. The cover of financial losses resulting from recalls minimizes risks.

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