BIICL Product Liability Forum

Insurance Perspectives on Product Liability

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1. Introduction

In the light of developments in product safety regulation and legislation, at both national and international levels, appropriate and effective product liability insurance has become increasingly important.

Notwithstanding all due risk management measures being in place, an insured may find itself subject to significant claims in respect of products manufactured or supplied. Product liability insurance which will respond in a manner fitting to both the insured's profile and business is essential to protect the insured from the consequences of such claims.

The purpose of this paper is to provide an overview of product liability insurance principles in the UK, including certain common terms of cover, and to highlight some of the differences of law and principle in other jurisdictions.

2. Insurance Principles

Prior to considering various specific issues relating to product liability insurance, it will assist to review some general principles which apply to all insurance contracts subject to English law. Notably, and in contrast to some other jurisdictions we have considered, these general principles tend to provide a degree of protection to the insurer both prior to the formation of the insurance contract and during the period of the insurance itself.

2.1 Utmost Good Faith

The principle of "utmost good faith" applies to all insurance contracts and has a number of consequences for both insureds and insurers. The most important (and a frequent subject of litigation) is the duty on the insured to disclose all facts which are material to the insurer's consideration of the risk at the proposal stage. The insured is deemed to know, and is required to disclose, every material fact which in the ordinary course of his business ought to be known to him. The exceptions to this duty of disclosure are material facts which the underwriter already knows, which are in the public domain or of which the underwriter has waived disclosure. The duty of disclosure is in addition to the insured's general contractual duty not to make false representations in respect of material facts which induce the insurer to enter into the insurance contract.

For the purposes of both non-disclosure and misrepresentation, whether or not facts are material is judged by a two part test (Pan Atlantic v Pine Top [1994] 2 Lloyd's Rep 427). Facts are material if:

(1) A prudent underwriter would have deemed the facts not disclosed or misrepresented to have been material.
(2) The non-disclosure or misrepresentation induced the actual underwriter to accept the risks on the terms which he agreed.

If an insured misrepresents or fails to disclose a material fact prior to the formation of the insurance contract, the insurer may *avoid* (that is to say treat the insurance contract as if it had never existed). On avoidance, the insurer must repay any premium received and the insured must return any claims paid.

The remedy of avoidance applies even if the misrepresentation or non-disclosure was entirely innocent. To limit the harsh consequences of this principle, insurance contracts may include an "innocent non-disclosure" clause, which provides that the insurer will not rely on a non-disclosure or misrepresentation if the insured can establish that it was innocent. Such clauses are, however, rarely found in product liability insurance contracts.

A duty is imposed on the insured to make complete and accurate disclosure at the proposal stage in most jurisdictions. However, the remedies for breach and the circumstances in which those remedies are available vary widely.

In some jurisdictions, the position is similar to the UK. For example, in Switzerland, failure to make proper disclosure enables the insurer to treat the insurance contract as void without proof of prejudice (article 6 Federal Law on Insurance Contracts). In addition, the insurer may retain the premium paid, a more onerous position than in the UK. In Austria, incomplete or inaccurate disclosure entitles the insurer to rescind (section 16 Versicherungsvertragsgesetz ("VersVG")).

In Portugal, whether in good or bad faith, failure to inform the insurer of all facts and matters relating to the risk renders the insurance contract a nullity. In the Netherlands, provided that with true knowledge of the facts the insurer either would not have accepted the risk or would have accepted it on different terms, incomplete or inaccurate disclosure will entitle the insurer to avoid, again, whether or not it was in bad faith (paragraph 251 of the Code of Commerce).

In Japan, both insured and insurer are under an obligation not to betray the other's trust. This obligation imposes a duty on the insured to be honest and straightforward and to make full and accurate disclosure of all material facts. The insurer is likewise under a duty to make full and accurate disclosure. A failure by the insured to disclose a material fact will render the policy voidable at the option of the insurer. Prejudice to the insurer is not required. Further, the insurance contract usually contains an express stipulation regarding the duty of disclosure and prescribing the manner in which it is to be performed. Breach of the duty of disclosure will, accordingly, also amount to a breach of the insurance contract.

In most jurisdictions, however, the situation is more favourable to the insured.
In the USA (New York), the failure of an insured to respond truthfully to a question asked by an insurer, the answer to which is material to the risk, may render the insurance contract voidable irrespective of bad faith. If, however, the insured fails to disclose material information that was not enquired into by the insurer, the non-disclosure may need to be intentional for the insurer to be entitled to avoid.

In Australia, the insured is required to disclose every matter that he knows, or a reasonable person in the circumstances could be expected to know, is relevant to the insurer's decision to accept the risk and the terms to accept it on (section 21 Insurance Contracts Act 1984). If the insured fails to make complete and accurate disclosure, unless the insurer would have entered into the insurance contract for the same premium and on the same terms in any event, the insurer may avoid the insurance contract if the misrepresentation or non-disclosure was fraudulent.

Otherwise (or if the insurer elects not to avoid) the liability of the insurer in respect of any claim under the insurance contract is reduced to the amount that would place the insurer in the position he would have been in if complete and accurate disclosure had been made (section 28 Insurance Contracts Act 1984).

In Spain, if the insured fails to make proper disclosure, the insurer is entitled to terminate the insurance contract in the month following the discovery of the failure and retain the premium for the expired period of the insurance contract (section 10 Insurance Contracts Law). If, in the meantime, a loss has occurred, the insurer will be entitled to reduce proportionately any payment made in respect of that loss to reflect the difference between the premium actually paid and the premium that would have been charged had proper disclosure been made. Furthermore, during the course of the insurance contract, the insured is also obliged to disclose any circumstances arising which may aggravate the risk (section 11 Insurance Contracts Law). If such disclosure is made, the insurer may either re-rate or terminate the insurance contract (section 12 Insurance Contracts Law). If it is not made, if a loss has occurred, the insurer may decline cover if the insured acted in bad faith. Alternatively, the insurer may proportionately reduce any payment made in respect of the loss to reflect the difference between the premium actually paid and the premium that would have been charged had a re-rating occurred.

In France, the insurance contract will be null and void only if the failure to make proper disclosure is intentional and either changes the subject of the risk or decreases the insurer's assessment of the risk (article L.113-8 of the Insurance Code). If there is no bad faith and the failure is discovered prior to a loss occurring, the insurer may continue the insurance contract in consideration for an increase in premium or terminate the insurance contract and return the premium for the unexpired period of the policy. Once a loss has occurred, as in Spain, the amount to be paid by the insurer in respect of the loss will be proportionately reduced to reflect the difference between the premium actually paid and the premium that should have been paid (article L.113-9 of the Insurance Code).

In Italy, incomplete or inaccurate disclosure may result in total or partial inability to recover or termination of the insurance contract (articles 1892 to 1894 of the Civil Code).

In Malaysia, the insurer may repudiate liability, but must show prejudice. Unusually, if the insurer breaches the duty to disclose, he may be liable to a penalty of RM1 million (Insurance Act 1996).

In Denmark, the position is particularly favourable to the insured. The insurance contract remains binding on the insurer save where the misrepresentation or non-disclosure is fraudulent (section 4 of the Insurance Contracts Act). If it is innocent, the contract is unaffected (section 5 Insurance Contracts Act). If it is negligent, the insurer will only be exempt from liability under the insurance if it would not have insured the risk had the true facts had been known (section 6 Insurance Contracts Act).

2.2 Warranties

A warranty in an insurance contract is a contractual promise made by the insured that a condition has been or will be fulfilled or a state of affairs exists or will continue to exist.

Whether or not a particular term of an insurance contract is a warranty will be construed by reference to the policy as a whole. The fact that the insurance contract in some way describes the term as a warranty will be persuasive, although not conclusive. A number of factors point to a term being a warranty, including the fact that it goes to the root of the insurance contract and that damages would be an unsatisfactory or inadequate remedy for breach. If there is any doubt as to whether a term is a warranty, the term will be construed in favour of the insured.

One of the most common warranties is known as a “basis clause”. A proposal form will usually contain a declaration by the insured that the information contained in it will form the basis of any subsequent insurance contract. As a consequence, the declaration will be incorporated into the insurance contract by reference. The effect of this provision is that the insured warrants the truth of the information in the proposal so that insurers may be discharged from liability if any of it should prove untrue.

The insured must comply with a warranty strictly. If a warranty is breached, the insurer is automatically discharged from all liability from the date of the breach. The insurer need not show prejudice.

Warranties are not universally recognised in jurisdictions other than the UK. Jurisdictions where they are recognised include the Netherlands and Spain. In the Netherlands, breach of warranty will allow the insurer to terminate the insurance contract unless, in certain circumstances, the insured can prove that the breach is not related to the recovery they seek. In Spain, the duty on the insured to mitigate any loss suffered is recognised as a warranty. If the insured wilfully breaches this duty, the insurer is entitled to refuse an indemnity or reduce the indemnity by an appropriate amount (section 17 Insurance Contracts Law). In Japan, a “basis clause”, pursuant to which the insurer may be discharged from liability in the event that the proposal contains false information, is also a common feature.

In Australia, by contrast, there is no meaningful distinction between a warranty and any other term of the insurance contract. In any event, statutory restrictions mean that where any term of an insurance contract is breached, the insurer may not refuse to pay a claim. Instead the claim will simply be reduced by the extent to which the breach prejudices the insurer (section 54 Insurance Contracts Act 1984). In the USA (New York), whilst warranties are recognised, they are not often encountered.

2.3 Conditions Precedent

Breach by the insured of the terms of an insurance contract, other than warranties, will generally entitle the insurer only to claim damages, unless the term breached is a condition precedent.

Conditions precedent may relate to validity or, more usually, to liability. Where there is a breach of a condition precedent to the validity of an insurance contract, the insurer will not come on risk and any premium paid is returned. Conditions precedent to liability under the insurance contract are usually concerned with claims (i.e. taking precautions against claims and notification of claims). If the insured breaches a condition precedent to liability, irrespective of whether it has suffered prejudice, the insurer will be entitled to refuse to provide an indemnity in respect of the claim in question.

Whether or not a term is a condition precedent will depend on both the nature of the term and the construction of the insurance contract as a whole. The insurer's intention in relation to the term must be clear. In this regard, explicit language will assist, but will not be conclusive. Conditions precedent may be specifically so described, or words may be used to make it plain that breach will prevent recovery. Alternatively, the insurance contract may include a "due observance" clause which provides that the observance of all or certain terms shall be a condition precedent to the insurer's liability. In rare circumstances, compliance with a term will be so fundamental that it will be held that the insurer intended the term to be a condition precedent despite the absence of express language.

Conditions precedent are recognised in some jurisdictions other than the UK. For example, in Malaysia, breach of a condition precedent will entitle to insurer to resist a claim made by the insured irrespective of whether the insurer has suffered prejudice. Having said that, in 1995, the Malaysian Central Bank issued Claims Settlement Guidelines which stipulate that, save where fraud is suspected, a claim cannot be denied merely on the basis of technical breaches of policy conditions or warranties which are not material to or connected with the loss. The scope and force of these guidelines have not, however, been tested in the courts. In civil law jurisdictions, the law may impose duties on the insured in respect of claims, breach of which may have the same effect as breach of a condition precedent (see section 5 below).

3. The Product Liability Insurance Contract

3.1 The Insuring Clause

The insuring clause in a product liability insurance contract typically provides that the insurer will indemnify the insured for:

> "*all sums which the insured shall become legally liable to pay as damages or compensation* ***in respect of*** *accidental death or bodily injury of any person and/or accidental loss of or* ***damage*** *to property in the course of or in connection with the insured's business caused by or arising out of the insured's products*".

Most product liability insurance contracts contain definitions of terms such as "products" (usually to include labelling, packaging, instructions etc.) and "property" (usually to include only tangible property). If there is no relevant definition, or the definition is unclear, the court will construe such terms with the aim of giving them the meaning intended by the parties.

3.2 Damage

"Damage to property" will usually be defined in the insurance contract. The definition, however, can be tautologous and may do little to elucidate what is actually meant. As a result, what constitutes "damage", particularly in the context of the mixing of different products and the contamination of one product by another, has been the subject of several recent court decisions.

One case concerned carbon dioxide supplied to the drinks industry for mixing with other ingredients to produce carbonated drinks. As a result of a breakdown in the manufacturing process, the carbon dioxide contained benzene. The Court of Appeal held that, on mixing with the carbon dioxide, the other ingredients ceased to exist and a new product was formed. Therefore, there was no damage to property (that is to say damage to the other ingredients) but, instead, the creation of a new defective product. Accordingly, the policy did not respond (Bacardi-Martini Beverages Ltd v Thomas Hardy Packaging Ltd and Others [2002] 2 Lloyd's Rep 379).

Another case involved white pigment used in the production of u-PVC compounds, from which doors and window frames were subsequently manufactured. In certain environmental conditions, the white pigment caused the doors and window frames to turn pink. The issue was whether this amounted to damage to property, defined in the relevant insurance contract as including *"physical injury to or destruction of tangible property"*. The Commercial Court held that an unwanted change in colour was a physical change and, if the discolouration impaired the value of the product, was a physical injury. Accordingly, there was property damage under the insurance contract (Tioxide Europe Ltd v CGU International Insurance Plc [2004] 1 Lloyd's Rep 114). Unlike the carbonated drinks in the above case, the doors and windows were not defective from the outset but instead became defective at a later stage.

In other jurisdictions, damage to property generally requires damage to the substance or the integrity of an object, to include loss or destruction. The position as regards mixing and contamination in some jurisdictions, such as Portugal and Denmark, is the same as in the UK. In the USA (New York) whether mixing causes damage will depend on the degree of the mixing and whether it is possible to separate the products. In other jurisdictions, for example France and Malaysia, the point is yet to be decided by the courts.

3.3 "In respect of"

Most product liability insurances cover only claims for bodily injury and property damage caused by defective products. There is generally no intention to cover claims for "pure economic loss", that is to say financial loss which is not consequent on bodily injury or damage to property. For this reason, the UK courts have consistently held that the words *"in respect of"* bodily injury or damage to property require a causative link between the event giving rise to liability and its physical consequences, such that pure economic loss will not be covered.

In one case, the insured supplied loose soap powder to a wholesaler for packaging in cartons. The soap powder was defective in that it stained the cartons. This allowed moisture in to the cartons which caused the soap powder to cake. The wholesaler claimed against the insured and was awarded damages, including damages for the cost of cartons purchased for future sales and loss of future profits. The insured's product liability insurance covered liability "*in respect of any Occurrences"*. The definition of "Occurrence" included loss or damage to physical property caused by the insured's goods. The Court of Appeal held that this definition confined cover to liability for physical consequences caused by the insured's goods. The damages for the cost of cartons and loss of profits for future sales were not covered. Those damages were not referable to the liability *in respect of* the material "Occurrence" (the damage caused by the defective soap powder to the cartons it was packed in) but were instead referable to the insured's failure to supply soap powder thereafter (Rodan International Ltd v Commercial Union Assurance Co [1999] Lloyd's Rep IR 495).

Restrictions are put on the insured's ability to recover pure economic loss under a product liability insurance contract in most jurisdictions, whether by the relevant law, the courts' decisions on phrases such as *"in respect of"*, or the terms of the insurance contract itself. In Spain, for example, the Supreme Court has decided that pure economic loss is not recoverable against insurers. In Australia, however, in certain circumstances, claims for pure economic loss may be held by the courts to be covered.

3.4 Financial Loss Extensions

Had the product liability insurance in the Rodan case contained a financial loss extension, the insured's liabilities arising from the damages awarded for the cost of cartons and future loss of profits may well have been covered.

A financial loss extension, covering the insured's liabilities in respect of claims for pure economic loss (generally loss of profits or loss of goodwill) caused by the insured's products, is commonly offered with product liability insurance. Such liabilities usually arise from claims against the insured for breach of contract, pure economic loss not being recoverable for negligence save in limited circumstances. A number of exclusions are applied by insurers to financial loss cover including loss arising from liability assumed by contract and from failure to supply.

Financial loss extensions are available in many other jurisdictions on similar terms.

3.5 Claims Made / Losses Occurring

Product liability insurance may be offered either on a *"losses occurring"* or a *"claims made"* basis.

Losses occurring insurance covers bodily injury or property damage which happens during the period of insurance, notwithstanding the fact that a claim may not be made until a much later date. Difficulties may arise in establishing when the injury or damage has occurred. Unless the insurance contract states otherwise, this will generally be when material injury or damage first occurs.

Claims made insurance covers claims in respect of bodily injury or property damage which are made during the period of the insurance. A "claim" in this context is usually defined as a demand for payment or any other remedy (be it through legal proceedings or less formally) against the insured by a third party. The advantage for the insurer of claims made cover is certainty. At the end of the period of insurance, they will know precisely what claims have been made.

Whilst product liability insurance contracts are increasingly being offered on a claims made basis, losses occurring cover remains the most common in the UK. In most other jurisdictions, losses occurring cover is also most common, although in some jurisdictions, for example the Netherlands, it is becoming increasingly unavailable.

To prevent uncertainty for the insurer, losses occurring insurance contracts may include a term excluding cover for claims made outside a fixed period after the expiry of the period of insurance. This is common in Switzerland. In addition, in Switzerland, only claims made cover is usually available for risks in the USA or Canada. It is noteworthy that in France, following a number of court decisions holding claims made clauses null and void, the law now specifically provides that claims made insurance cover is available in certain circumstances (law 2003-706 dated 1 August 2003).

4. Exclusions

Product liability insurance contracts in all jurisdictions contain a variety of common exclusions. These generally relate to risks which are likely to be covered by other insurances, risks arising from the deliberate conduct of the insured, uncertain or potentially catastrophic risks or damage to the product itself. The standardisation of these exclusions is, to a large extent, driven by the requirements of international reinsurers.

A number of these common exclusions are described below.

4.1 Designs, Specifications, Instructions and Advice

Product liability insurance frequently excludes liability arising from designs, specifications, plans, formulas, instructions or advice in connection with the insured's product.

As the purpose of this exclusion is to avoid overlap with the insured's professional indemnity cover, rather than to exclude liability for design (rather than manufacturing) defects, it usually applies only where a fee is charged.

If the insured has no professional indemnity cover, a professional indemnity extension to the product liability insurance may be available.

4.2 Deliberate Conduct

Product liability insurance is designed to cover injury and damage caused accidentally rather than purposely. Accordingly, the consequences of the insured's deliberate acts will normally be excluded. In France and Portugal, the consequences of deliberate acts are excluded by law.

4.3 Fines, Penalties, Liquidated and other Enhanced Damages

The indemnity provided by product liability insurance is for compensatory damages the insured is liable to pay to a third party. It is not for aggravated, exemplary or punitive damages, which reflect the level of culpability of the insured rather than compensate the third party. Likewise, it is not for fines the insured may be ordered to pay in criminal courts, nor penalties or liquidated damages the insured may have agreed to pay in the event of a breach of contract. Accordingly, most product liability insurance contracts exclude these types of losses arising from the insured's products.

4.4 Standard: Pollution, Asbestos, Electromagnetic fields

Due to potentially catastrophic losses and high clean up costs, product liability insurance contracts frequently exclude, whether partially or completely, the insured's liability for asbestos, pollution and contamination, radiation and electromagnetic fields.

Most UK product liability insurance contracts implement the wording, either in its original or an adapted form, recommended by the Association of British Insurers to exclude liability for gradual pollution or contamination (such as long standing leaks from pipes or tanks). This wording excludes all liability for pollution or contamination other than that caused by *"a sudden identifiable unintended and unexpected incident* *which takes place in its entirety at a specific time and place during the period of insurance"*.

4.5 Contractual Liability

At the time of agreeing to provide cover, the insurer will not know the extent of the insured's contractual liabilities and will not, therefore, be able to consider the risk with reference to them. That being so, liability assumed by the insured under an agreement, which would not otherwise have attached is usually excluded.

The excluded liability may take a variety of forms including, for example, sums which the insured is required to pay under any guarantee. The insured's liability pursuant to certain contract terms implied by statute (i.e. terms as to satisfactory quality or fitness for purpose implied by the Sale of Goods Act 1979) will often not be excluded.

4.6 Product Recall, Repair and Replacement

The insured's liability arising out of recalling, removing, repairing, replacing or reinstating any defective products and the loss of, damage to or diminution in value of the insured's products which arises out of any defect in the product or the harmful nature or unsuitability of the product is usually excluded from cover. Cover in respect of these types of liability may be available by way of separate product guarantee or product recall insurance (see sections 6 and 7 below).

5. Conditions

Product liability insurance contracts in the UK commonly contain terms governing how the insured should conduct itself both generally during the period of the insurance and in the event that a claim is made against it. These terms are frequently expressed to be conditions precedent to the insurer's obligation to indemnify the insured, although whether they are in fact conditions precedent will depend on the considerations in section 2.3 above. Similar obligations are placed on the insured in most other jurisdictions, whether by the terms of the insurance contract or by law, with varying sanctions for breach.

A number of these common conditions are described below.

5.1 Reasonable Care

The insured will usually be required by a condition of the insurance contract to take all reasonable precautions to prevent any occurrence, accident, injury or damage which may give rise to liability under the insurance and to prevent the sale or supply of goods which are defective in any way.

However, as the purpose of product liability insurance is to provide cover to the insured in respect of negligence, in the UK, such a condition will not be breached merely because the insured was negligent in not taking reasonable precautions. What must be proved is that the insured acted recklessly, in that he recognised a danger and did not care whether or not it was averted. "Reasonable precautions" does not mean every practicable precaution. Whether a precaution is reasonable or not will depend on the circumstances of the case and will be determined by what is reasonable as between the insured and the insurer with regard to the commercial purpose of the insurance contract.

In the Netherlands, except in relation to certain specified insurances, the insured is obliged to take measures to prevent or minimise loss. If he does not do so, he may be required to indemnify the insurer for any damage caused (paragraph 283(2) of the Code of Commerce).

5.2 Notification Requirements

A condition requiring the insured to give notice within a certain time of any circumstances which may or are likely to give rise to a claim and of any claims or legal proceedings actually brought against the insured will be included in all UK product liability insurance contracts. "Likely" in this context means there is a more than 50% chance of a claim being made on an objective assessment. "May" requires a smaller chance of a claim being made, although a claim must at least be possible.

Compliance with this condition enables the insurer to investigate the (potential) claim, control any proceedings and take steps to mitigate any loss as soon as possible. The condition will usually require the insured to give notice within a specified time frame, alternatively either "immediately" (with all reasonable speed in the circumstances) or "as soon as possible" (as soon as reasonably possible for a person in the position of the insured). If no time is set out in the condition, notice must be given within a "reasonable" time. The form of the notice, to whom it must be given and what information it must contain will also usually be set out in the condition.

In Switzerland the insured is under a duty to give immediate notice of loss. If there is an intentional breach of this duty, the loss will not be covered. If there is a negligent breach which causes prejudice to the insurer, the indemnity may be reduced or, if the insurance contract so provides, extinguished (article 39 Federal Law on Insurance Contracts). In the Netherlands, except in relation to certain specified insurances, the insured is also obliged immediately to notify the insurer of any loss. If the insured does not do so, if there are sufficient grounds, he will be liable to indemnify the insurer for any damage caused (paragraph 283(2) of the Code of Commerce). In Denmark, the insured must report any loss without undue delay. If he does not do so, the insurer will be liable for the loss only to the extent that it would have been liable had the loss been properly reported (section 21 Insurance Contracts Act).

In Italy, notice of loss must be given within three days, failing which the insurer may refuse the indemnity or reduce it to the extent of the prejudice suffered (articles 1913 and 1915 of the Civil Code). In Spain, the insured has seven days in which to notify the insurer of any loss. If he fails to do so, the insurer will be entitled to damages for any loss caused by the delay (article 16 Insurance Contracts Law). In Portugal, the insured must notify the loss within eight days. If the insured notifies late, he will be liable for any damage to the insurer resulting from the late notification (article 440 of the Commercial Code). In the USA (New York), a failure to provide notice for a period as short as one month has been held to bar cover as a matter of law. An insurer need generally not show prejudice to bar cover on grounds of late notice.

5.3 Claims Co-operation and Claims Control

Product liability insurance contracts in the UK usually contain a claims co-operation and/or a claims control condition.

A claims co-operation condition requires the insured to co-operate with the insurer in respect of any claim brought against it. The co-operation required may include prompt notification of the claim, the provision of any information and assistance required by the insurer and refraining from settling claims without the insurer's consent.

A claims control condition will entitle the insurer, if they wish, to control and settle any claims against the insured and to take proceedings in the name of the insured against third parties to recovery their outlay under the policy. Where an insurer conducts the defence of or settles any claim against the insured, it must do so in good faith and in the interests of both itself and the insured.

In Austria, if all information and documents demanded by the insurer are not provided by the insured, the insurer may by law decline to make any payment (article 34 VersVG). In Spain, the insurer may refuse an indemnity if the insured wilfully or grossly negligently fails to provide information about a loss (article 16 Insurance Contracts Law).

6. Product Recall Cover

In most jurisdictions, insurers offer product recall cover, either by way of separate insurance or (more rarely) by way of an extension to an insured's product liability insurance. In the UK it is more usual for product recall cover to be offered by way of separate insurance, providing also product guarantee and financial loss cover. The recall expenses covered are likely to include the costs of transporting the defective products, the costs of advertising the recall, storage and disposal costs, the costs of replacing the products and, in some cases, product rehabilitation and (albeit to a limited extent) loss of profits.

In the UK, product recall cover may be provided on one of two bases. Firstly, cover may be provided in respect of the insured's expenses in recalling its products following malicious or accidental contamination and in meeting any extortion demand in respect of its products. Secondly, cover may be provided in respect of expenses incurred by the insured as a result of recalling any defective product because its use may cause the insured to incur a legal liability to pay third party damages or because, as a result of its failure to perform in accordance with its specification, it requires removal, repair or replacement.

The insurer of a product recall insurance contract will wish to ensure that the insured does not knowingly supply defective products to the market. For this reason, most product recall insurance contracts will exclude claims arising from products in the custody of the insured or not accepted by the insureds' customers and from circumstances of which the insured is aware at inception. In some jurisdictions, the consent of the insurer will be required before any recall takes place. In other jurisdictions, for example Switzerland and Spain, before cover is given, the insurer may require the decision of a court or other competent authority that a recall is necessary. A recall plan or recall organisation may also be required.
Following the introduction of the General Product Safety Directive (Directive 2001/95/EC of 3 December 2001), the number of product recalls in Europe has increased significantly. New General Product Safety Regulations, implementing the directive, will come into force in the UK later this year. The impact of these regulations on product recall cover in the UK remains to be seen.

7. Product Guarantee Cover

Product guarantee cover may also be available, either by way of separate insurance or by way of an extension to the insured's product liability insurance. As noted above, in the UK, product guarantee cover tends to be offered by way of separate insurance providing product recall, product guarantee and financial loss cover.

Product guarantee cover provides an indemnity to the insured, not where the product has caused bodily injury or property damage to a third party, but instead where the product is defective or has failed to perform in accordance with its specification and has suffered a diminution in value or requires repair or replacement as a result.

Product guarantee cover is available in most jurisdictions. It is not, however, available in Japan. In jurisdictions other than the UK where it is available, the terms will generally be individually negotiated, the applicable exclusions will be numerous and the premium will be high.

8. Concluding Remarks

Manufacturers and suppliers require insurance programmes that will respond to international liabilities. Some multi-national businesses will have both a global master product liability insurance contract and local product liability insurance contracts. The master product liability insurance contract will provide cover to the extent that it is not available in certain individual jurisdictions by law.

There is a large degree of commonality in both the general conditions and the exclusions to be found in product liability insurance contracts in various jurisdictions. These similarities are, to a large extent, driven by the requirements of international reinsurers. However, there are plainly very significant differences between the underlying principles of insurance contract law in different jurisdictions.
Insurers and insureds alike need to take care in transacting insurance business and consult as appropriate with both their insurance brokers and their legal advisers for the jurisdictions in which they intend to make their products available.

Acknowledgements

This paper was produced with kind assistance from: Alison Clarke, Reynolds Porter Chamberlain; Paul Baram, Deacons, Sydney, Australia; Robert Byrd, Byrd & Associates, Paris, France; Henrique Chaves, Chaves, Cruz Martins, Queiroz De Barros, Roquette & Associates, Lisbon, Portugal; Tim Diveley, The Chubb Corporation, Warren, New Jersey, USA; Aidan McCormack, Nixon Peabody LLP, New York, USA; Jan ter Meer, Boekel De Nerée NV, Amsterdam, The Netherlands; Azmi Mohd Ali, Azmi & Associates, Kuala Lumpur, Malaysia; Shigeru Ogiso, Yuasa and Hara, Tokyo, Japan; Lorenzo Pallesi, Studio Legale Carnelutti, Rome, Italy; Gabriele Platteter, Masser, Grossman, Klingsbigl, Lirsch & Masser, Vienna, Austria; Fred Rueff, Roesle Frick & Partners, Pfäffikon, Switzerland; Juan-Antonio Ruiz, Cuatrecasas, Barcelona, Spain; Jan Wittenborn, Bech-Bruun Dragsted, Copenhagen, Denmark

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November 2005

Profiles

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Alex Hamer is an insurance and reinsurance lawyer with particular expertise in liability work including product liability. Alex's product liability practice encompasses a broad range of industries. Recent work has related to electrical and telecoms products, commercial software, pharmaceuticals, drinks and food products, agricultural supplies and defective packaging. His work frequently involves a primary focus on the insurance and reinsurance coverage aspects of products claims in addition to liability advice. He also advises on liability policy wordings. Alex is a member of the Product Liability Forum of the British Institute of International and Comparative Law. He also delivers seminars on insurance and product-related topics.

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We are founder members of Terralex, an international network of 140 independent law firms and over 12,000 lawyers in nearly 100 countries. This provides us with a presence in a large number of jurisdictions and as a result, we can provide advice on claims worldwide.

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