

**TOTAL RECALL:  
WHAT POLICYHOLDERS AND CARRIERS  
NEED TO REMEMBER WHEN FACED WITH  
LEAD PAINT-RELATED CLAIMS**

Presentation at Mealey's Lead Litigation Conference

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## **I. Introduction**

The Roman Empire, conqueror of Carthage, victor at Alexandria, and tamer of barbarian Europe, met its downfall after its governing nobility was slowly ravaged by the lead lining in their wine jugs.<sup>1</sup> A scant 2,000 years later, after a decades-long campaign against lead in consumer products, occurrences of lead poisoning in the Western world have become increasingly rare. However, against the backdrop of heightened trade tensions that sensationalized any China-related story, 2007 saw a surprising spike of lead-related product recalls.<sup>2</sup>

The press began to focus on the story of lead-tainted products in May of 2007 when federal regulators announced large voluntary recalls of Chinese-made children's jewelry.<sup>3</sup> One month later it became clear that the problem was widespread, when RC2 Corporation recalled 1.7 million Thomas & Friends toy trains because the lead content of their paint exceeded allowable levels.<sup>4</sup> Shortly thereafter, RC2 was also forced to recall the special gift it had sent customers who had first responded to the initial recall.<sup>5</sup> Later that summer, Fisher-Price announced it was recalling nearly a million toys featuring Sesame Street and Dora the Explorer characters because of lead paint fears.<sup>6</sup>

Of all lead paint recalls, "more than half . . . have occurred since January 2004," and "[m]ore than 80 percent of those items came from China."<sup>7</sup> Midway through 2007, at

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<sup>1</sup> *Lead in Drinking Water*, U.S. News & World Report, May 12, 1986, at 73.

<sup>2</sup> Maurice Possley, *Senator Seeks Probe of Unsafe Toys; Products From China are a Key Concern*, Chicago Tribune, June 26, 2007, Maurice Possley, at 3.

<sup>3</sup> Diane C. Lade, *Test Finds High Lead Levels in Some Kids' Jewelry*, Fort Lauderdale Sun-Sentinel, May 6, 2007, at 1A.

<sup>4</sup> *Judge Halts Settlement on Tainted Toys*, Chicago Tribune, Jan. 30, 2008, at C2.

<sup>5</sup> David Leonhardt, *Lessons Thomas Still Could Learn*, N.Y. Times, Oct. 24, 2007, at C1.

<sup>6</sup> Jim Landers, *Liability Not Always Easy to Pinpoint in Imports*, Dallas Morning News, Aug. 15, 2007, at 8A.

<sup>7</sup> Maurice Possley, *Senator Seeks Probe of Unsafe Toys; Products from China are a Key Concern*, Chicago Tribune, June 26, 2007, at C3.

least 24 separate toys had been recalled in the United States for various reasons; all of them had been manufactured in China.<sup>8</sup>

Predictably, lawsuits followed. Mere days after the recall of the Thomas & Friends toys, plaintiffs filed a lawsuit against RC2 seeking to enjoin the company from producing or distributing any additional train toys.<sup>9</sup> Two months later, RC2 was sued by parents seeking payment for ongoing medical monitoring of their children.<sup>10</sup> Mattel was sued in September by plaintiffs seeking to force the company to pay for testing of children who may have been exposed to lead-tainted toys.<sup>11</sup> In October, investors sued Mattel alleging that it had "misled investors by delaying the reporting of defects in its toys to federal regulators."<sup>12</sup>

Like many large-scale commercial events, the lead paint recalls have left a trail of economic damages in their wake. And economic damage trails always lead to insurance. Although there have been no reported insurance coverage decisions relating to lead paint recalls, such cases are surely on the horizon. This article provides a general overview of the lines of coverage that potentially respond to toy recalls and what policyholders can do to protect their rights to that coverage.

## **II. Product Liability and Recall Litigation**

### **Toy Recall Litigation**

#### *1. Lead Paint Litigation*

The lead paint standard was established by the Federal Hazardous Substances Act

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<sup>8</sup> *All Toys Recalled for Safety in '07 Were Made in China*, Orlando Sentinel, June 19, 2007, at A10.

<sup>9</sup> Maurice Possley, *Lawsuit Seeks Halt to Sale of Recalled Thomas Toys*, Chicago Tribune, July 4, 2007, at C1.

<sup>10</sup> Michael Higgins, *Couples File Suit Over Lead in Toys; Thomas Trains Recalled in June*, Chicago Tribune, Aug. 14, 2007, at 1.

<sup>11</sup> *Suit Seeks to Recover Cost of Lead Testing*, The Gazette, Aug. 8, 2007, at B6.

<sup>12</sup> *Investors Sue Over Mattel Toy Defects*, L.A. Times, Oct. 11, 2007, at C6.

("FHSA"). Toys or other articles intended for children that expose children to hazardous amounts of lead are banned under the FHSA. The Consumer Products Safety Commission ("CPSC") does not have statutory authority to require companies to stop using lead in consumer products if the levels released are not hazardous but, in August 1998, the Toy Manufacturers of America pledged that its members would completely eliminate lead from their products.<sup>13</sup> However, in the 12-month reporting period ended September 30, 2007, 19 of 61 toy recalls in the United States were because of lead paint.<sup>14</sup>

As of this writing, there is a bill pending before Congress (H.R. 4040) which directly addresses the lead paint recall issue. Among other things, this bill establishes a national standard for lead content in toys. Unlike the voluntary lead level of 600 parts per million, H.R. 4040 incorporates a new initial federal standard of 300 parts per million, and 100 parts per million after three years. A version of this legislation, which has also been passed by the Senate and has the support of the White House, is expected to be enacted within the second quarter of 2008.

a. RC2 Litigation

Perhaps the most well-known litigation in connection with a lead paint recall is that involving RC2 Corporation. In June 2007, RC2, the manufacturer of Thomas & Friends Wooden Railway toys, voluntarily recalled certain wooden railway vehicles because the surface paint contained lead. A total of 1.5 million sets were recalled. RC2 recalled additional Thomas & Friends products in September 2007 for the same reason.

Shortly after the recall, RC2 found itself facing fourteen class action lawsuits –

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<sup>13</sup> *Toy Manufacturers Agree to Rid Products of Lead*, U.S. Consumer Product Safety Commission Newsletter, Release # 98-154, August 20, 1998.

<sup>14</sup> *"Thomas" Toymaker Settles Suit Over Lead for \$30 Million*, Julie Schmit, USA Today, 2008.

nine in Illinois and one each in Arkansas, California, Indiana, New Jersey and New York. The Judicial Panel on Multidistrict Litigation transferred the federal lawsuits to the United States District Court for the Northern District of Illinois (the “MDL Action”). RC2 chose not to remove all of the cases that had been filed in various state courts. During the pendency of the MDL Action, RC2 entered into a nationwide settlement and obtained preliminary approval of that settlement in one of the state court cases filed in the Circuit Court of Cook County, Illinois.<sup>15</sup> The proposed settlement, with an asserted value of \$30 Million, calls for reimbursements for hundreds of thousands of consumers and improved product safety measures.<sup>16</sup> If finally approved, consumers will be reimbursed in cash for recalled toys or offered a replacement plus a bonus toy, if they prefer.<sup>17</sup> Customers who lack toys and proof of purchase can obtain \$15 coupons.<sup>18</sup> In addition, RC2 has committed to increase testing and auditing, improve U.S.-overseas communication, and require contract manufacturers to meet its testing and auditing standards.

On January 22, 2008, the Court granted preliminary approval of the terms of the proposed settlement. The settlement will resolve all class claims of persons in the United States who purchased or own the Thomas & Friends Wooden Railway products that were recalled in June and September of 2007. In connection with this settlement, the Company reportedly expects to record in the 2007 financial results a charge in the range of \$3.5 million to \$4.5 million, net of tax, to cover estimated additional replacement costs or refunds, donations, notice charges, claims administration and legal fees related to this

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<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

settlement.

b. Other Litigation

The RC2 recall began a domino effect of other notable manufacturers recalling toys due to high levels of lead, including among others, Fisher-Price (Sesame Street-themed products for infants and preschoolers) and Mattel (over 2 million toy cars, trains, shape-sorters, and Barbie doll accessories). All recalls were in cooperation with the CPSC's guidelines, and all were voluntary recalls, according to the CPSC news releases. However, these additional recalls have lead to additional litigation.

In August 2007, a class action lawsuit was filed against Mattel in Los Angeles Superior Court. The suit was brought on behalf of a family from Fontana, California and alleges that Mattel was negligent in allowing lead-contaminated toys to be sold to consumers.<sup>19</sup> The plaintiffs seek establishment of a fund to pay for medical screening and monitoring of children who may have developed lead poisoning.<sup>20</sup> The plaintiffs also seek monetary damages and compensation for injuries.<sup>21</sup> Multiple law firms are currently working on filing similar class actions against Fisher-Price.

State governments are also joining the growing tide of litigation. In November 2007, the California Attorney General filed a lawsuit in Alameda County Superior Court against twenty companies, including toy companies (e.g. Mattel, Toys "R" Us, and RC2) and general distributors (e.g. WalMart and Target) for selling toys containing "unlawful quantities of lead." The complaint seeks \$2,500.00 in fines against the companies for each violation of the Safe Drinking Water and Toxic Enforcement Act of 1986.

These lawsuits are just the first wave of litigation related to the lead paint recalls.

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<sup>19</sup> *Mattel Recall: No Reason to Put Children's Health at Risk*, Heidi Turner, October 9, 2007.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

As cited above, there were 19 toy recalls in the United States in 2007 for lead based paint. There are certain to be more such recalls in 2008 and, as a result, a source of potential litigation for both toy manufacturers and distributors for years to come.

2. *Other Toy Recall Litigation*

In addition to the lead paint recalls, there have been a growing number of toy recalls based upon other dangerous or defective conditions in toys. These recalls are also inspiring a number of class action lawsuits.

a. Magnet Recalls

In 2006, Mega Brands recalled nearly 4 million Magnetix toys made by Mattel after the company received reports of injuries and death to small children due to the ingestion of the toy's magnets. It was reported that, if the magnets were ingested, they could pinch internal organs, tear through the stomach or intestinal lining, and even cause death. Just six months after the voluntary recall, Mega Brands agreed to pay \$13.5 million to settle a class action lawsuit filed by the families of 15 victims. Mattel may be facing similar lawsuits in regard to its Polly Pocket doll play sets. In response to reports that three children suffered serious injuries from swallowing small magnetic parts, Mattel recently recalled 2.4 million Polly Pocket doll play sets.

b. Aqua Dots Recalls

The CPSC, in cooperation with Spin Master of Toronto, Canada, announced a voluntary recall of Aqua Dots on November 7, 2007. The toy was recalled after scientists found that it contained a chemical that converts into a powerful "date rape" drug called GHB, or gamma-hydroxy butyrate, when ingested. It was found that when Aqua Dots beads are eaten, the compound GHB can induce unconsciousness, seizures, drowsiness,

coma and death.

Similar to other toy recalls, class action lawsuits against Spin Master have been springing up across the United States. One such lawsuit, pending in Arkansas, seeks to force Spin Master to refund consumers' money for the purchase of the Aqua Dots. The class representatives, an Arkansas couple who bought Aqua Dots for their three young children, are seeking to prevent the company from forcing the estimated 4.2 million customers to accept a replacement toy, rather than a refund.

### **III. Insurance Issue Spotting**

#### **A. Carrier's Perspective**

The past decade has seen a dramatic increase in product recalls within industries as varied as pharmaceuticals, food and drink manufacturers and tire manufacturers. The insurance products available to provide coverage to consumer products manufacturers for recall expenses have historically been quite limited. The commercial general liability policy that has been the standard insurance product for businesses historically only provided limited coverage for recall related expenses and, under more recent forms, completely excludes such expenses. However, the insurance industry has responded to the upward trend in product recalls by developing product recall insurance. Product recall insurance is still a specialty product offered only by a few carriers, yet it is destined to play an important role in this expanding risk.

##### *1. Commercial General Liability Policy*

In order to understand the necessity of product recall insurance to a consumer manufacturing business, it is necessary to first understand the limits of the standard insurance product for such businesses – the commercial general liability insurance policy (“CGL”). Under this type of policy, the insurance company will pay all damages that the

insured becomes obligated to pay because of bodily injury or property damage caused by its products.

Beginning in 1966, insurance companies added to the standard-form CGL policy an exclusion that sought to preclude coverage for activities that the insurance industry believed were business risks of developing and marketing a product.<sup>22</sup> This exclusion was known as the “sistership exclusion.” The exclusion reads as follows:

**Recall of Products, Work or Impaired Property**

Damages claimed for any loss, cost or expense incurred by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of:

- (1) “Your product”;
- (2) “Your work”; or
- (3) “Impaired property”;

if such product, work or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or dangerous condition in it.

The standard form CGL policy defines “your product” as follows:

**“Your product”:**

- a. Means:
  - (1) Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:
    - (a) You;
    - (b) Others trading under your name; or

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<sup>22</sup> *Alleviating the Nightmare: Insurance for Product Recalls*, Lorelie Masters and John Kazanjian, The Metropolitan Corporate Counsel, June 2001.

- (c) A person or organization whose business or assets you have acquired; and
- (2) Containers (other than vehicles), materials, parts, or equipment furnished in connection with such goods or products...

“Your work” is defined as follows:

**“Your work”:**

- a. Means:
  - (1) Work or operations performed by you or on your behalf; and
  - (2) Materials, parts or equipment furnished in connection with such work or operations...

Finally, “impaired property” is defined as follows:

**“Impaired property”** means tangible property, other than “your product” or “your work”, that cannot be used or is less useful because:

- a. It incorporates “your product” or “your work” that is known or thought to be defective, deficient, inadequate or dangerous; or
- b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by:

- (1) The repair, replacement, adjustment or removal of “your product” or “your work”; or
- (2) Your fulfilling the terms of the contract or agreement.

The “sistership exclusion” barred coverage for the costs incurred when a policyholder recalled a product that it suspected may cause injury or damage.<sup>23</sup> As one court observed:

The sistership clause was developed to protect insurers against liability for the cost of recalls. The clause’s name, in fact, reflects this purpose. Following an accident involving a defective airplane, the airplane manufacturer became obligated to recall the airplane’s sister ships in order

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<sup>23</sup> *Id.*

to correct the common defect that caused the crash of the first airplane. Insurance companies...developed the sistership clause to make clear that, while they intended to pay for damages caused by a product that failed, they did not intend to pay for the costs of recalling products containing a similar defect that had not yet failed.<sup>24</sup>

Similarly, the “sistership exclusion” did not limit coverage where the policyholder had not withdrawn the product and its product had already caused damage to others: “The effect of--[the “sistership exclusion”] is to exclude claims for damages caused by the purchaser’s withdrawal of the insured’s products from use due to a deficiency in them. Such a result does not affect other possible instances of product liability, such as those in which damages occurs to a person or to property other than the product of the insured itself.”<sup>25</sup>

Insurance industry documents written at the time the exclusion was first added to the standard CGL policy confirm this point.<sup>26</sup> In 1966, a policy drafter for the Hartford Insurance Group confirmed that the exclusion did not apply when the product had injured or damaged others: “This exclusion applies only to products which are withdrawn prior to causing injury. It does not apply to particular ‘items’ which have actually caused bodily injury or damage to property other than the ‘item’ itself.”<sup>27</sup>

Accordingly, the “sistership exclusion” applies when: (1) the withdrawal was made by the policyholder, and (2) the withdrawal took place before actual injury or damage arose.<sup>28</sup> This is the typical scenario faced by most companies involved in a

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<sup>24</sup> *Forest City Dillon, Inc. v. Aetna Cas. & Sur. Co.*, 852 F.2d 168, 173 (6th Cir. 1988).

<sup>25</sup> *Commercial Union Assurance Co. v. Glass-Lined Pipe Co.*, 372 So.2d 1305, 1309 (Ala. 1979).

<sup>26</sup> *Alleviating the Nightmare: Insurance for Product Recalls*, Lorelie Masters and John Kazanjian, The Metropolitan Corporate Counsel, June 2001.

<sup>27</sup> *Id.* (citing Letter from Harold Schaffner, Hartford Insurance Group, to Robert F. Bauer, Assistant Secretary, Johnson & Higgins (August 5, 1966)).

<sup>28</sup> *Id.*

product recall today. Accordingly, a new product has emerged to provide coverage for such recalls.

## 2. *Product Recall Coverage*

Product recall coverage is considered a relatively new product within the insurance industry. A standard form for product recall insurance was approved by the Insurance Services Office just a few years ago, in 2004. Although it is difficult to measure the size of the market, it is among the fastest growing areas in the insurance industry.

“Product recall is a very broad term, and the extent of coverage can vary greatly,” explains a Vice President for Chubb.<sup>29</sup> “It may be limited to product withdrawal or product tampering. Product withdrawal expense insurance usually covers the expenses associated with the announcement of the withdrawal, shipping costs and disposal of a product. Product tamping, as the name implies, is associated with losses incurred with products that are tampered with.”<sup>30</sup> The product recall form may also include both withdrawal and tampering coverage.

The following are two representative product recall coverage forms:

### **Policy A:**

We will pay for expenses you incur for the withdrawal of your product or impaired property, when such withdrawal is made necessary by reason of determination by the insured or by any ruling of any governmental body that the use of such product or property could result in bodily injury or property damage, because of any known or suspected defect, deficiency, inadequacy or dangerous condition in it. This insurance applies only to expenses incurred from withdrawal of such product or property, initiated during the policy period and within the coverage territory.

Policy A defines expenses to include *only* the following:

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<sup>29</sup> *Product Recall Insurance*, Phil Zinkewicz, March 2005 (quoting Jill Wadlund, Vice President and Life Science Casualty Manager for Chubb).

<sup>30</sup> *Id.*

- The cost of telephone and telegraphic communication, radio or television announcements, newspaper advertising;
- The cost of stationary, envelopes, production of announcements and postage thereof;
- The cost of remuneration paid to regular employees of the insured for necessary overtime;
- The cost of hires by the insured of persons other than the regular employees of the insured.

**Policy B:**

The company shall reimburse the insured for loss arising out of the recall of an insured product during the policy period from a distributor, purchase or user of such product, which occurs as a result of any of the following insured events:

- Accidental omission of a substance in the manufacture of the insured product; or
- Accidental introduction or accidental substitution of a substance in the manufacture of the insured product; or
- Error in the design, manufacture, packaging, blending, mixing, compounding, labeling or storage of the insured product; or
- Intentional damage to the insured product by an employee or by a third party.
- Provided that the use of the insured product has resulted or would result in widespread physical injury or widespread property damage caused by or because of the four points above and that the insured adheres to the recall plan in responding to the recall.

Policy B defines costs as follows:

Any reasonable and necessary costs incurred by the insured to inspect, withdraw, destroy, repair or replace the insured product. This may include, but is not limited to the following:

- The cost of communications to notify others of an insured event resulting in a recall, including but not limited to radio or television announcements and internet or printed advertisements;
- The cost of shipping the insured product from any purchaser, distributor or user to the place or places the insured designates;

- The cost to hire additional persons other than the insured's regular employees;
- Remuneration paid to the insured's regular employees, other than salaried employees, at basic wage rates, necessary straight time or overtime;
- Expenses incurred by employees, including transportation and accommodations;
- The extra expense to rent additional warehouse or storage space for a maximum period of 12 months;
- The actual cost of disposal of the insured product, but only to the extent that specific methods of destruction other than those usually employed for trash discarding or disposal are required to avoid bodily injury or property damage as a result of such disposal;
- The actual cost to redistribute any recalled or restored insured products;
- Reasonable and necessary fees and costs of independent security, public relations or recall consultants to assist the insured in responding to an insured event, provided that the company has given prior consent to the use of such independent specialist companies. These fees and costs are not subject to any deductible under this policy.

The two policy examples illustrate common elements. For example, both policies allow for reimbursement of such standard recall expenses as the cost of informing the public of the recall, the cost of having the product returned or destroyed, overtime expenses for regular employees and the cost of hiring outside persons to assist in the recall process.<sup>31</sup>

However, there are also some major differences between the two sample policies. Policy A bases coverage on the insured's determination of necessity, while Policy B's coverage is narrower because it is limited to the occurrence of specific events.<sup>32</sup> Policy A includes a listing of specific costs covered by the policy, while Policy B bases

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<sup>31</sup> *Insuring Against Product Liability*, Michael Lemov and Jason Hewitt, ABA Section of Business Law, Business Law Today, September/October 1999.

<sup>32</sup> *Id.*

reimbursement on “any reasonable and necessary costs” as well as listed covered costs.<sup>33</sup>

Finally, Policy B requires approval by the insurance company of an insured’s recall plan and requires adherence to the plan by the insured.<sup>34</sup>

## **B. Policyholder’s Perspective**

As indicated above, the lead paint-related toy recalls impact different entities: manufacturers; distributors; and retailers. Because each of type of entity maintains its own specific insurance program, the “policyholder’s perspective” cannot be viewed through a single lens. Rather, different entities will approach recall-related coverage issues in different ways. There are, however, three general strategies that can benefit each type of policyholder: (i) identifying potential coverage; (ii) understanding that coverage; and (iii) proactively approaching the recall-related insurance claim.

### *1. Identifying Potential Coverage*

The first step for any entity confronted with a toy recall-related claim is to identify the potential sources of “coverage.” For many companies, particularly distributors and retailers “downstream” from the manufacturer of the offending item, thoughts of coverage do not immediately go to insurance. Instead, those entities may look exclusively to their supply contracts. Like their counterparts in other industries, toy distributors and retailers frequently build indemnification provisions into their supply contracts. Such provisions obligate the “upstream” party to bear the financial burden of recalls.

Before concluding that a given recall-related claim is “covered” by their supply contract indemnification provision, downstream entities should have a very clear

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<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

understanding of what stands behind their supplier's indemnification obligation. It is quite possible that the Chinese manufacturer of a lead-paint-containing toy is insufficiently capitalized to indemnify the downstream losses resulting from a large-scale recall. And, even if the indemnity obligation is backed by an insurance policy, there is no guarantee that such a policy is underwritten by the type of carrier, or at the coverage levels, that indemnitee itself would have chosen.

As with hurricane insurance, by the time the recall clouds start to gather, it is too late for an affected party to purchase a new policy. Consequently, even though they might not like what they find standing behind an indemnification provision, it is essential for the entity faced with a recall-related claim to know exactly what existing insurance policies potentially respond. Ideally, this information is obtained before a recall-related claim arises. At the very least, it should be gathered as soon as a claim is on the horizon.

The policies of which manufacturers, distributors and retailers should be aware fall into two basic categories: policies under which they are "named insureds;" and policies under which they are "additional insureds." The "named insured" policies are straightforward -- they are the insurance contracts that an entity negotiates, purchases and keeps for itself. Copies of the policies in this category should be easily accessible, and generally familiar, to the entity seeking coverage.

"Additional insured" policies are insurance contracts which -- pursuant to an indemnification provision or by other agreement -- provide coverage to entities beyond the one that negotiated and purchased the policy. An additional insured usually shares the same rights and obligations as a named insured. Consequently, although it may be

difficult to obtain copies of the policies that fall into this category, any “additional insured” is well-advised to do so.

## 2. *Understanding The Potential Coverage*

Once an entity facing a recall-related claim has identified the potentially applicable policies, it is essential for that entity to understand the terms, conditions and exclusion of those policies. From the basic issues (like policy limits and deductibles/self-insured retentions) to the more complex questions (such as the applicability of exclusions), any toy recall-related insurance recovery will begin with an understanding of the insurance contracts.

As indicated in section A above, the two lines of coverage most likely to be implicated by toy recalls are commercial general liability (“CGL”) policies; and “specialty” or product recall (“Recall”) policies. A brief overview of these policies illustrates how a failure to understand the coverage can compromise a legitimate claim.

CGL and Recall policies, like all insurance policies, require policyholders to give notice of claims or potential claims “as soon as practicable.” How soon is “soon enough” varies from state-to-state. States such as New Jersey deny coverage claims on “late notice” grounds only where the insurer has been prejudiced by the delay.<sup>35</sup> New York courts, on the other hand, do not necessarily consider prejudice to the insurer and may deny coverage if notice was not given “within a reasonable time” under the circumstances.<sup>36</sup>

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<sup>35</sup> See *Gazis v. Miller*, 892 A.2d 1277 (N.J. 2006) (lack of compliance with notice provision will not bar coverage absent “appreciable prejudice” to insurer).

<sup>36</sup> See, e.g., *Greenwich Bank v. Hartford Fire Co.*, 164 N.E. 876, 881 (N.Y. 1928) (twelve-day delay reasonable); *Schiebel v. Nationwide Mut. Ins. Co.*, 560 N.Y.S.2d 801 (N.Y. App. Div. 1990) (denying coverage for late notice);

Depending on the state law governing a given recall-related insurance claim, the timing of the policyholder's notice can make or break coverage. For this reason, even where it is only an "additional insured," an entity that is impacted by a toy recall should take immediate action. It should not rely on another party, such as its indemnitor, to give notice on its behalf.<sup>37</sup> Nor should it wait until it is actually named in a given suit. Instead, the affected entity must anticipate recall-related problems, understand its obligations under all available policies, and comply with its responsibilities. Failure to do these things can result in the forfeiture of coverage.

Just as a lack of compliance with its notice obligations can prevent an entity from obtaining otherwise available coverage, a failure to understand the substantive provisions of a policy can cause a manufacturer, distributor or retailer to leave coverage "on the table."

By way of a CGL example, a quick read of the "sistership exclusion" may cause a policyholder to conclude that no toy recall coverage is available under any CGL policy containing such a provision. Such is not the case.

First, as indicated above, the sistership exclusion only applies to products that are withdrawn before they cause injury. Thus, this exclusion would not preclude coverage for toy recalls rooted in actual lead poisonings or other ingestion-related injuries.

Moreover, the sistership exclusion does not eviscerate all recall-related claims that are not driven by actual injury. Instead, it only applies where the policyholder's "product," "work" or "impaired property" is recalled. This distinction is significant in the toy recall context, where a retailer can sustain losses caused by the recall of a manufacturers' product. Whereas the sistership exclusion might prevent the

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<sup>37</sup> See, e.g., *City of New York v. Welsbach Elec. Corp.*, 852 N.Y.S.2d 134, 135 (N.Y. App. Div. 2008).

manufacturer from recovering under its CGL policy, an “additional insured” retailer could still have a viable claim.<sup>38</sup>

Similarly, manufacturers, distributors and retailers unfamiliar with their Recall policies risk leaving that coverage uncollected. As was illustrated above, there can be major differences in the coverage provided by Recall policies. Some respond only to predetermined and enumerated costs and events, while others cover all costs and events that the “policyholder” deems necessary. Likewise, some require the carriers’ pre-approval of a recall plan, whereas others leave the recall response to the discretion of the policyholder.

While by no means exhaustive, the foregoing examples demonstrate the importance of knowing and understanding potentially available insurance coverage. Any entity impacted by a toy recall will have various options as to how it will respond. Only a clear understanding of the policy terms will ensure that the chosen response is consistent with the corresponding insurance coverage claim.

### *3. Proactively Approaching the Insurance Claim*

It is not enough for a “named insured” or an “additional insured” to simply identify and understand the potentially applicable policies. Instead, as soon as they become aware of a potential recall, toy manufacturers, distributors and retailers must proactively advance their recall-related insurance claims. The most important step in that direction is enlisting the right people for the job.

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<sup>38</sup> Cf. *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 78 Cal. App.4th 847, 866-67 (Cal. App. 2000). In *Shade Foods*, Shade was listed as an additional insured in a policy held by one of its suppliers. *Id.* at 862. When the supplier’s input contaminated Shade’s product, the court held that an “impaired property” exclusion in the supplier’s policy did not exclude coverage for Shade because Shade’s product could not be “deconstructed to remove the injurious [contaminants.]” *Id.* at 866.

Not surprisingly, the number of internal personnel assigned to handle a toy recall is directly proportional to the size and sophistication of the affected entity. Large corporations will generally include executives, public relations personnel and in-house counsel on their recall response teams, whereas smaller companies may be forced to face the recall with an internal team of one.

Regardless of a company's size, a major recall is a major crisis, and its associated cost is a major concern. As a result, companies big and small may be tempted to reduce costs by handling the problem entirely "in house." Policyholders should fight this temptation, because when it comes to insurance, the failure to hire the right help can be particularly penny wise and pound foolish.

In virtually every case, outside counsel will be retained to advise on the most appropriate response to a toy recall. Most often, companies will hire such counsel for their litigation or regulatory expertise. Although the recall itself requires the services of such experts, class-action litigators and consumer affairs specialists often lack specialized insurance expertise. Because of the direct relationship between the way in which a recall is handled and the availability of insurance coverage, it is essential that insurance coverage counsel be added to, and work closely with, the recall response team.

Insurance consultants are the other "outsiders" who can play a key role in maximizing any recall-related insurance recovery. Once the correct policies have been identified and their terms and conditions satisfied, the question becomes: "How much is the policyholder entitled to recover?" The answer to the question is not simply the amount of extra expenses incurred as a result of the recall. Instead, recovery depends on fitting recall costs into the categories enumerated in the applicable policies, and

documenting those expenses as they are incurred. In answering the question of “how much?”, toy manufacturers, distributors and retailers are well-served by retaining consultants who specialize in quantifying recall-related damages and documenting corresponding insurance claims.

Whether the applicable insurance policies cover specifically enumerated losses, or all "reasonable and necessary" costs, it is essential for the policyholder to accurately tally and present its damages. Insurance damages consultants are the experts in this field. Ideally, such consultants will join the recall response team at the outset, document the damages as they accrue, and assist in the preparation and submission of the resulting insurance claim. Later, if the claim is denied and coverage litigation becomes necessary, the insurance consultant can serve as an expert witness on the issue of damages. To be sure, insurance damages experts represent an additional expense. However, the cost of adding them to the response team can be far outweighed by the insurance recovery that they ultimately substantiate.

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In sum, toy recalls impact manufacturers, distributors and retailers. Although specific insurance programs and recall responses vary, any entity that seeks to maximize its insurance recovery should: (i) identify what policies potentially respond to the recall; (ii) understand the terms, conditions and exclusions of those policies; and (iii) engage a comprehensive team of “in house” and “outside” experts to document, submit and defend the recall-related damages. From the policyholder’s perspective, following these simple steps will give this toy story a much happier ending.

#### **IV. Conclusion**

The very old problem posed by lead-paint contamination continues to generate very modern consequences. The insurance industry is evolving in response to widespread product recalls like those necessitated by lead-paint contamination. Companies can incur substantial costs conducting a product recall, and before long may find themselves exposed to liability in class action lawsuits. Carriers and policyholders alike must evaluate their current coverage for applicability to the damages wrought by lead-paint recalls. New coverage, like that provided by recall-specific policies, should be considered as well. Just as the Romans were to “first learn the meaning of what you say, and then speak,” both policyholders and insurers must know their coverage before problems arise, and legal battles ensue.