

LIABILITY CLAIMS TAKEAWAYS

Welcome to the 28th edition (April 2023) of 'Liability Claims Takeaways' - our monthly insights from industry stalwarts.

April 2023



Content

- Professional Indemnity Insurance
- Commercial General Liability Insurance
- Directors' and Officers' Liability Insurance

What was the claim?

The Insured was in the business of providing boutique technology and software services to its customers. In order to provide such specific and tailored services to its customers, it partnered with a third-party agency that acted as the Insured's service provider ('Service Provider'). Additionally, the Insured, from time to time used the resources of a manpower outsourcing agency (contractor), which enabled the Insured to work with temporary contractors for specific projects for a limited period of time. During one such project, one of the temporary employees of the Insured committed an error in interpreting the end customer's instructions, which resulted in an incorrect design being developed by the Service Provider. Since the deliverable was rejected owing to the incorrect interpretation of the design by an employee of the Insured, the Service Provider suffered extensive loss as a lot of resources were used by them in the production stage. The Service Provider claimed these losses from the Insured, which the Insured notified and claimed under its Professional Indemnity Insurance Policy ('PI Policy').

Professional Indemnity Insurance

Key aspects to remember:

1. Customised cover for the Insured's business:

- Typically, the operating clause of a PI Policy would reimburse the Insured for losses due to claims arising out of actual or alleged wrongful acts committed in the performance of professional services for which the Insured received a fee. The Insured's policy was no exception and had a similar operating clause. However, since our team was familiar with the Insured's business model, they had, at the time of placement, also procured an endorsement to include a wider scope of services by the Insured and losses to third parties (not limited to clients) on account of various services provided by the Insured.
- The appointed Surveyor in this case, only relied on the operating clause of the policy and initially opined that the Insured's claim is not payable since the loss was suffered by the Insured's service providers, not clients, and therefore did not trigger the Policy coverage.
- Fortunately, since our team had already procured an endorsement to widen the scope of cover, the insuring clause of the policy stood amended to include all losses suffered by third parties while the insured carried out its professional services. This endorsement did not have any requirement for a claim to be preferred against the Insured by a client or recipient of the Insured's services.
- Therefore, we were able to elucidate to the surveyor the intention behind issuing the said endorsement, which clearly protected the Insured from all claims they may face while performing its professional services, irrespective of who is making this claim. The surveyor eventually was aligned with our submission and the claim was assessed as a payable claim by the Surveyor.



2. Loss mitigation – Insured’s duty:

- The employee who committed this error was not a permanent employee of the Insured but was a contractual employee (for which the Insured had availed a specific endorsement). Basis the agreement between the Insured and the contractor, all losses suffered by the Insured, on account of the contractual employee were to be borne by the contractor.
- Therefore, the Insured had a recourse, besides its insurance policy, to recover the loss suffered by it on account of the error committed by the contractual employee.
- However, owing to the business relations between the Insured and the contractor, the Insured was initially not in favour of claiming these losses from the contractor. Our team advised the Insured that while the insurance coverage acts as the means to put the Insured in a position it was in prior to suffering the loss, the Insured cannot sleep on its duties and not make all attempts available to recover the loss which ideally should be available to it.
- Acting on our advice, the Insured claimed the loss value from the contractor, however, the contractor was unable to make good the losses to the Insured owing to their financial position. The insurer and surveyor were provided with all necessary proof in support of this stand taken by the contractor. Thereafter the Insurer, being satisfied with the loss mitigation measures of the Insured, agreed to reimburse the losses suffered by the Insured and in exchange, the Insured agreed to provide unconditional support to the Insurer.



What was the claim?

The Insured is a producer of frozen food items and has a factory in Jalandhar, Punjab. On one occasion, the Insured manufactured a batch of frozen kababs ('Product') and sold it to their customer in Chandigarh who would then sell it to the end customer, a chain of food trucks. When the Product was received by the customer, they were found to be inedible due to the presence of an external substance in one of the packets. Since the Product was meant for human consumption, the entire batch was rejected. The Insured had to recall the Products and incurred costs in respect of transportation. Since these Products had a low shelf life, they could not be used and had to be disposed of. Additionally, the Insured's customer failed to deliver it to the end customers who lost their sales for two days and claimed the same from the Insured's customer who in turn claimed it from the Insured. The Insured filed a claim under the Commercial General Liability Policy ('CGL Policy').

Commercial General Liability Policy

Key aspects to remember:

1. Coverage for Product Recall:

Product Recall cover indemnifies the Insured for any cost which the insured incurs to recall the products manufactured by the Insured. Such recall should be on account of the recall, removal, recovery of possession or control, or disposal of the Insured's product because the use or consumption of the product has resulted in bodily injury or property damage, or objectively poses an actual and imminent danger of resulting in bodily injury or property damage.

Therefore, if a bodily injury/property damage has occurred or there is a potential threat that bodily injury/property damage can occur, if the Product of Insured were to be used, coverage under the product recall clause will trigger subject to the cost falling within the ambit of the product recall expenses definition.

Product recall expenses generally include the cost of transportation, storage (cost incurred to rent additional space), destruction of the product, cost to hire any additional persons or remuneration paid as overtime to the regular employees at basic rates of salary or wage, cost incurred to notify the general public of the incident and cost to redistribute/repair the recalled product to render them marketable.

In the subject claim, due to the recall of the spoilt batch, the Insured incurred the following costs:

- a. Cost of transportation to bring back the spoilt products.
- b. Cost of disposal of spoilt products.
- c. The Insured gave a bonus of INR 5,000 to their salaried employees as a gesture for their hard work.

Considering the costs being covered under product recall expenses, the cost incurred by the Insured for transportation and disposal of the products was covered under the CGL Policy. The additional cost borne by the Insured on account of paying a bonus to their employees was not covered since the CGL Policy only covers the following in relation to the remuneration paid:



- a. The cost to hire additional persons who are not the employees of the Insured to assist in the recall arising out of a Covered Incident.
- b. Remuneration paid to the regular employees, other than salaried employees, at basic rates of salary or wage for necessary straight time or overtime.
- c. Any expenses incurred by employees such as transportation and accommodation due to recall.

2. What is covered under Financial Loss?

Financial Loss cover in the CGL Policy reimburses the Insured for any damages, costs, and expenses that the Insured becomes legally liable to pay to the Insured's customers or third parties, as a result of any financial loss which is incurred by them as a result of inter alia recall of Insured's product.

In the subject claim, since the Product of the Insured that was supplied to their customer was spoilt, it had to be recalled. As a result, the chain of supply was affected, and the end customers could not receive the Product on time resulting in a loss of a sale to them. The end customers made a claim on the Insured's customer, who in turn claimed it from the Insured, holding them liable for the loss.

These costs were covered under the financial loss cover of the CGL Policy as these were a result of business loss suffered by the Insured's customer due to the recall of the Insured's Product. These costs are neither covered under the product recall expenses nor product guarantee.

3. Cost of Insured's own goods not covered.

When a claim arises, there are, often, two types of costs that the Insured incurs – first-party cost and third-party cost. First-party costs are costs which are the expenses incurred by the Insured owing to the incident. While a third-party cost is a cost which the Insured becomes legally liable to pay to the third party because of the incident. A CGL Policy protects the Insured from both first-party and third-party expenses to the extent covered under the CGL Policy. The CGL Policy does not reimburse the cost of the Insured's own Product.

In the subject claim, the Insured had to recall the spoilt Products and their customer refused to pay the cost of the Product. Further, since the Product had been spoilt, the Insured did not have the option to filter out the unspoilt kababs to be sold again in the market. Since the Insured had to bear the cost of the Product supplied for which they could not receive the invoice value from the customer, they claimed the same under the CGL Policy. The sale price of the defective goods does not find coverage under the CGL Policy. The CGL Policy only covers the cost of replacing defective products. However, if the Insured is unable to recover cost of the goods supplied from the customer, the CGL Policy will not reimburse such losses which is purely in the nature of short recovery.



What was the claim?

The Insured entity was being bought over by another leading group of companies. The deal was signed on September 31, 2018, and the transaction was closed on October 31, 2018, on which date the share purchase was to be completed. Prior to the transaction, the Insured terminated a contract with one of their customers. Around October 2019, one of the Insured's directors retired who had signed the termination notice. On February 1, 2020, the Insured's customer filed a case against the Insured and its director alleging wrongful termination and breach of the contract. The Insured filed a claim under its Directors' and Officers' Liability Insurance (D&O Policy) in order to seek cover for the director under the D&O Policy.

Directors' & Officers' Liability Insurance

Key aspects to remember:

1. Impact of an acquisition on a D&O Policy – Run-off

Once any Insured entity has been acquired, the existing D&O Policy of the company ceases to exist due to the change in ownership. To protect the directors and officers of the Insured against any claim being made against them after the transaction has taken place, for actions taken by them prior to the transaction, a Run-off endorsement is made available to them.

A D&O Policy is a claims-made policy, typically for a period of one year. A Run-off works like an extended reporting period of the existing D&O Policy of the acquired company where the Insured Persons can notify claims for a fixed number of years after the acquisition transaction, provided the claim is connected to their actions taken prior to the transaction. Under a Run-off Policy, the date of the transaction becomes the date on which the Run-off would commence.

As soon as the Insured informed us about the transaction, our team of experts contacted the Insurer's team of underwriters and procured a Run-off Policy for the Insured for a period of 6 years from the date of Run-off. In the subject claim, since the date of the transaction was October 31, 2018, and therefore, the date of the Run-off Policy was October 31, 2018. In this claim, the case was filed on February 1, 2020, for an allegedly wrongful termination around September 2018, therefore, the matter was notified under the Run-off Policy.

2. What if the Insured entity refuses to indemnify the Insured person?

A Run-off Policy has the same provisions as the D&O Policy of the Insured meaning that all the coverages, exclusions, terms, and conditions applicable to a D&O Policy would be applicable to a Run-off Policy. Under a D&O Policy, where the Insured entity is unable to indemnify the Insured person due to insolvency or where specifically required not to indemnify either by law or court order, the Insured's director or officer can seek indemnification directly from the Insurer.

However, the D&O Policy provides that if the Insured entity is legally permitted or required to indemnify any Director or Officer against whom a claim is made but fails to do so, then the Insurer shall advance all the costs within the applicable retention to the Insured Person, and the retention needs to be repaid by the Insured entity to the Insurer as soon as reasonably practicable.

In the subject claim, the allegation of the wrongful act was made against the ex-director in his official capacity and the Insured was required to indemnify the ex-director. Our team conducted a 'Know-your-policy session' with the Insured and explained the relevant terms and conditions of the policy along with the claims process to ensure that the claim is settled smoothly. Due to this 'Know-your-policy session' with the Insured, they were able to understand the key terms and conditions of the D&O Policy and agreed to indemnify the director. Once the retention, as set under the D&O Policy, was crossed, the Insurer started the reimbursement process of the defence cost. Also, since the Insurers were kept apprised and their consent was duly obtained for incurring the defence costs. They were cooperative from inception of this claim leaving the Insured with the experience of a smooth claim process.

We are sure you found the anecdotes interesting and got some key points to take away.
Stay tuned for the next edition!

About Prudent Insurance Brokers

We, at Prudent Insurance Brokers, provide industry-leading expertise in designing and managing insurance programs to address unique requirements of your organisation. We have a client-centric service infrastructure that delivers proactively & passionately in a highly systematic manner. Our Liability Team comprises exunderwriters and the largest number of qualified lawyers and legal professionals who can help you across different areas:

- Identifying and addressing gaps in your current insurance programs
- Arranging the most cost-effective cover from Indian and international markets
- Ensuring contract compliance for your insurable indemnities
- Offering 360° claims management by one of the largest claims teams across any broker in India
- Providing global solutions through the strongest international alliances

Our Claim-Handling Expertise

Our team members come from varied areas of expertise, thereby enabling us to ensure that our clients are assisted thoroughly, through every step of the claims handling process. We take pride in our professional competency and diligence, and our team is always willing to walk the extra mile in client service.





www.prudentbrokers.com

FOR MORE QUERIES, PLEASE REACH OUT TO:

Tanuj Gulani
tanuj.gulani@prudentbrokers.com

Neha Anand
neha.anand@prudentbrokers.com

Richa Dhasmana
richa.dhasmana@prudentbrokers.com

Jyoti Krishnan
jyoti.krishnan@prudentbrokers.com

Nishant Kashyap
nishant.kashyap@prudentbrokers.com

Mayank Sharma
mayank.sharma@prudentbrokers.com

Arun Prasadh
arun.prasadh@prudentbrokers.com

Hemangi Jhaveri
hemangi.jhaveri@prudentbrokers.com

Shreya Dave
shreya.dave@prudentbrokers.com

PRUDENT INSURANCE BROKERS PVT. LTD.

Registered Office: 101, Tower B, Peninsula Business Park, G.K Marg, Lower Parel, Mumbai - 400013

CIN No.: U70100MH1982PTC027681 | License No. 291 (Validity: 18th February 2023 to 17th February 2026)

Insurance is a subject matter of solicitation

This report and any recommendations, analysis or advice provided herein, are based on our experience as insurance and reinsurance brokers or as consultants, as applicable, are not intended to be taken as advice or recommendations regarding any individual situation. The opinions expressed herein are valid only for the purpose stated herein and as of the date hereof. We are not responsible for the consequences of any unauthorized use of this report. We have used what we believe are reliable, up-to-date and comprehensive information and analysis, but all information is provided without warranty of any kind, express or implied, and we disclaim any responsibility for such information or analysis or to update the information or analysis in this report. We accept no liability for any loss arising from any action taken or refrained from, or any decision made, as a result of or reliance upon anything contained in this report or any reports or sources of information referred to herein, or for actual results or future events or any damages of any kind, including without limitation direct, indirect, consequential, exemplary, special, or other damages, even if advised of the possibility of such damages. Please know the associated risks and the applicable charges, from your policy document issued by the insurance company. For more details on benefits, exclusions, limitations, terms and conditions, please read sales brochure/policy wording carefully before concluding a sale. Commencement of risk cover under the Policy is subject to receipt of payable premium to desired Insurance Company only. Prudent Insurance Brokers Pvt. Ltd. is the registered Broker with IRDAI and does not underwrite the risk or act as an Insurer.