# Contract manufacturer’s liability

## Questions & answers

### Why purchase Contract Manufacturer’s Liability cover?

In Australia, there is a growing trend for businesses to undertake contract manufacturing for a third party. Often, the third party will be a large brand name that is particularly sensitive to any brand and reputation impacts resulting from accidental contamination.

Accidental contamination during manufacture or packaging of the product can potentially result in substantial lost profits for the third party. Unfortunately, the insured may have only very limited cover for such losses under their General Liability (CGL) or Contaminated Products Insurance (CPI) policies.

The cover provided by stand-alone CGL policies in the market is typically limited to property damage that occurs at the insured’s premises, or to goods under the insured’s care, custody or control. This means that the insured may not have adequate cover for the financial loss suffered by their customers as a result of accidental contamination.

Most CPI policies, too, have very limited third party cover. They commonly may have include third party recall costs; however, any claim from a third party for their loss of profits is usually not covered.

Liberty International Underwriters (LIU) addresses this potential shortfall in cover with its Contract Manufacturer’s Liability (CML) Endorsement.

### What does it cover?

LIU’s CML Endorsement covers loss of earnings incurred by a third party as a direct result of accidental contamination of an affected product which the insured is manufacturing under contract for the third party.

LIU’s CML Endorsement also includes cover for defence costs.

### What are the key benefits of the cover?

LIU’s CML Endorsement offers:

- third party loss of earnings cover for up to 12 months
- automatic inclusion of defence costs
- limits up to $15,000,000.

### What sort of clients would be faced with this type of exposure?

Any manufacturer who manufactures or co-packs under contract for any third party. This can include the manufacture of generic products for retailers, as well as the manufacture of products for other parties.

## Case example

Muesli Bar Pty Ltd manufactured Krason-branded muesli bars for Krason Ltd. The cost to Muesli Bar Pty Ltd per product was $1.50, while Krason sold the muesli bars to retailers for $3.

The products were released to market and within the month, multiple consumer complaints were received by both retailers and Krason. Further investigation revealed that the product complaints related to a two-week period of production.

Muesli Bar Pty Ltd was informed of the complaints and upon investigation discovered that pieces of plastic had inadvertently made their way into the product. Krason and Muesli Bar Pty Ltd agreed a recall needed to be conducted.

Krason conducted the recall and sent their following invoice to Muesli Bar Pty Ltd. The chart below summarises the costs claimed, as well as the cover potentially provided by standard CPI and CGL policies, as compared with LIU's CPI policy with CML Endorsement.

| | | CPI Policy | CGL | CPI with CML |
|---|---|---|---|---|
| Retailer recall costs | $150,000 | ✓ | ? | ✓ |
| Advertising expenses | $50,000 | ✓ | ✗ | ✓ |
| Product replacement | $500,000 | ✓ | ✗ | ✓ |
| Krason's profit margin | $500,000 | ✗ | ✗ | ✓ |
| Krason's lost sales | $100,000 | ✗ | ✗ | ✓ |
| Total: | $1,300,000 | | | |
| **Total uninsured losses without CML:** | **$600,000** | | | |

The total loss incurred by Krason was $1,300,000; however, a typical CPI policy would only cover $700,000 of this loss. The difference in the amounts arises from the lost sales and profit margins by Krason, which are specifically covered by LIU's CML Endorsement.

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