

# Insurance Day

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Toy cars in a department store: a number of products manufactured in China were recalled because of fears they contained lead

## Insurers not liable for defence costs in tainted toys case

IN *Ace American v RC2 Corp*, a federal appeals court in Chicago has ruled an insurer has no duty under Illinois law to pay defence costs for a policyholder that sold lead-tainted toys that were manufactured in China and sold in the US, report Michael Wharfe, a senior associate in Steptoe & Johnson, and Angus Rodger, a partner in Steptoe & Johnson and chairman of the Inter-Pacific Bar Association's insurance committee.

The relevant "occurrence" was the sale of the toys in the US, not their manufacture or testing in China, and the policies excluded coverage for occurrences in the US.

Ace American provided commercial general liability cover to RC2, a company that designs, produces and markets toys manufactured in China, including "Thomas and Friends".

RC2 recalled some toys manufactured in China because they were found to contain lead. These toys had been sold and used in the US. The recalls resulted in numerous class actions.

RC2 had two lines of commercial general liabilities coverage: one domestic and the other international. The domestic line of policies covered occurrences within the US – but this line specifically excluded damages resulting from exposure to lead, and the insurers relied on the exclusion to deny coverage.

The international line, issued by Ace, excluded occurrences within the US. Ace sought to deny coverage, including any duty to defend the claims, on the basis the occurrence was in the US.

The key question was therefore where did the "occurrence" occur? Ace argued the occurrence took place in the US, when purchasers of the toys were exposed to the lead paint. RC2 alleged the occurrence extended to the place where the defective products were manufactured and tested, namely China.

At first instance, the court found in favour of the insured "because the negligent manufacture of the products had taken place in China, which was within

the coverage territory, the policies potentially covered the damages and Ace therefore had a duty to defend the claims against RC2".

This would have allowed coverage for injuries that took place in the US, on the basis a negligent act in the manufacturing process had taken place in a covered territory outside the US.

This decision was overturned on appeal. The appeals court noted: "It is undisputed the underlying lawsuits involve damages allegedly caused by exposure to lead paint that occurred within the US, which under the contract is entirely excluded from the coverage area. It is also undisputed the manufacture of the products occurred within the coverage area".

However, applying the policy terms in accordance with Illinois law, "the 'occurrence' that triggers coverage takes place where the actual event that inflicts the harm takes place. And based on the undisputed facts in this case, the 'occurrence' here happened at the location (or locations) of the exposure itself: within the US".

The international policies did not cover occurrences in the US, so Ace did not cover the losses and had no duty to defend.

Given the volume of products manufactured in Asia, and the particularly strong negative publicity that such products can attract in the US when problems come to light, it seems inevitable there will be many more class actions of this type.

In this case, applying Illinois law, the "occurrence" was deemed to be the sale of the products and consequential public exposure, not their manufacture. This produced a fortunate result for Ace, on its particular policy wording. If the policy had provided coverage only for US occurrences, and had excluded international risks, then the insurer could have found itself on the hook.

This case may be a reminder to liability insurers and their insureds to double-check whether their policies will respond to international product liability situations in the way they would expect.

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