KING & SPALDING

Client Alert

Insurance Coverage & Recovery Practice Group

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Insurance Coverage for Food and Beverage Contamination Claims and Recalls

Damages owed from illness and death claims resulting from actual or alleged food and beverage contamination, along with the cost of recalls of potentially contaminated products, present serious financial risk to companies involved in the manufacture or sale of food products. After a contamination event, all companies in the food supply chain—from farm to supermarket—may unexpectedly find themselves in the crosshairs, regardless of the ultimate source of the contamination. Moreover, even in cases where a business recalls its products before any injuries occur, a recall event may result in millions of dollars in lost profits, reputational damages, and claims by third-parties in the food production chain.

Paradoxically, the recently enacted Food Safety Modernization Act (the FSMA), which President Obama signed into law last year, may increase the frequency of costly recall events. The FSMA grants the U.S. Food and Drug Administration (the FDA) expansive powers to protect the nation's food supply, shifting the FDA's regulatory focus from reacting to food contamination to preventing it in the first place. The new act creates incentives for food companies to order prophylactic recalls before determining whether their products are actually contaminated—in essence, voluntary recalls—which could increase the frequency of product recall losses. Although many insurers offer product recall and contamination coverage—either as add-ons to commercial general liability (CGL) policies or as stand-alone products to fill gaps in CGL and first-party property coverage—in some instances these recall policies have not kept pace with the heightened recall risks faced by the food industry following passage of the FSMA, and they often contain hidden exclusions in definitions that insurers rely upon to deny coverage. Recent case law also shows that at least some courts are strictly construing these coverages in ways that may be at odds with policyholders' expectations.

Contamination and Recall Claims Under Commercial Liability Policies

Companies that purchase insurance to protect themselves against the risk of third-party food-borne illness claims should review those policies for the following:

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- Exclusions for "mold," "fungus," "bacteria," "contaminant" and/or "pollution" that should not relate to contamination in food products, as well as exclusions relating to "violations" of food safety regulations that could bar coverage.

- Definitions of key terms that relate to triggering coverage, such as "Accidental Contamination," which may or may not encompass "alleged" contamination, in addition to "actual" contamination.

- Coverage for claims that arise out of a company's own negligence in the manufacturing, packaging, or distribution of food products that may fall within the "your work" exclusion.

- Exclusions for reputational damages or lost sales following a high-profile contamination event.

- Self-insured retentions, per-occurrence limits, and hidden definitions of the term "occurrence" in "batch-lot" endorsements that may operate to expand or limit coverage, depending on the facts of a particular claim and policy wording.

Finally, policies may contain product recall exclusions that insurers may cite to deny coverage for third-party contamination claims that arguably relate to product recalls. Policyholders may be able to cite to conflicting policy exclusions to defeat these arguments and obtain coverage. (*See Security National Insurance Co. v. GloryBee Foods, Inc*., No. 09-1388-HO, 2011 WL 902635 (D. Or. March 15, 2011)). To avoid uncertainty over policy interpretation, many companies are turning to specialized contamination and product recall policies in an effort to reduce their exposure.

Specialty Contamination and Product Recall Coverage

In response to product recall and contamination exclusions in liability and property policies, and the increased risk of product recalls following the enactment of the FSMA, many companies are purchasing product recall and product contamination policies to fill gaps in their coverages. These policies generally cover the costs of the crisis response (i.e., notifying customers of a recall), costs associated with the recall itself (i.e., testing, shipping, storing, disposing of, and/or repairing the product), costs of rehabilitation (i.e., replacing the product and compensating third-parties to whom the company is contractually obligated to deliver the product), and lost profits resulting from the recall.

Recent case law suggests that certain of these specialty policies may not have kept pace with recent legislative and regulatory developments affecting the industry, and therefore may not cover FDA mandated recalls due to potential contamination if an insured's product is not ultimately determined to be contaminated. A company that acts responsibly and voluntarily recalls its products without being ordered to do so, and before the source of the contamination is actually known, needs to confirm that its product recall insurance will provide coverage for these recalls.

The recent case of *Fresh Express Inc. v. Beazley Syndicate 2623/623 at Lloyd's*, 131 Cal. Rptr. 3d 129 (Ct. App. 2011) is illustrative. In that case, after an outbreak of a virulent E. coli strain was traced to bagged spinach, the FDA issued an alert advising consumers not to eat bagged, fresh spinach. Not knowing which company's bagged spinach was responsible for the outbreak, the FDA further recommended that Fresh Express, the nation's largest bagged spinach producer at that time, recall its products. After the FDA determined the source of the outbreak (which was not Fresh

Express's spinach), it retracted the advisory, but not before Fresh Express had suffered a substantial loss of business. Fresh Express sought to recover these losses under its recall insurance policy, but the California Court of Appeals held that Fresh Express was not entitled to coverage, reasoning that Fresh Express's losses were not caused by "accidental contamination," which the policy defined as an error by Fresh Express that caused it to believe that use or consumption of its products could result in bodily injury. Because Fresh Express's losses were not the result of any error on its part, and despite the FDA advisory and recall recommendation, there was no "insured event" triggering coverage under the recall policy.

In *Little Lady Foods, Inc. v. Houston Casualty Co.*, No. 10 C 8280, 2011 WL 4473517 (N.D. Ill. Sept. 22, 2011), a court granted summary judgment to an insurer that denied coverage to Little Lady Foods on similar grounds. Little Lady had purchased a Malicious Product Tampering/Accidental Product Contamination insurance policy that provided coverage for losses resulting from "any accidental or unintentional contamination . . . provided that the consumption or use of [the products] has, within 120 days of such consumption or use, either resulted, or may likely result in . . . bodily injury, sickness, or disease." During the operative policy period, Little Lady began to use a new process for producing burrito products. Little Lady's internal company policy and USDA regulations required it to test for harmful bacteria on the new product prior to shipment. These tests revealed that listeria genus was present on six samples. There are seven strains of listeria genus, but only one strain causes illness if consumed. Because samples of the product tested positive for one of the seven strains, Little Lady performed additional testing, held back shipments, and made a claim under its Accidental Product Contamination policy. After the burrito product ultimately tested negative for the harmful strain, the insurer denied coverage on the ground that the losses did not result from an "accidental product contamination." Agreeing with the insurer, the Northern District of Illinois held that there was no coverage under the policy. The court concluded that Little Lady's losses did not fall within the policy's definition of "accidental product contamination" because none of Little Lady's products was actually contaminated with harmful bacteria, and there was no possibility that consumers could be harmed.

Similarly, a court granted an insurer's motion for summary judgment in *Caudill Seed & Warehouse v. Houston Casualty Co.*, No. 3:10-cv-299-jhm, 2011 WL 6370366 (W.D. Ky. Dec. 20, 2011). The recall coverage claim in that case arose when the FDA informed Caudill Seed that products made from contaminated peanuts that Caudill Seed had purchased and processed into peanut butter "posed an acute, life-threatening hazard to health." The FDA approved of Caudill Seed's decision to recall such products. Caudill Seed's insurer denied coverage under Caudill Seed's Accidental Product Contamination policy on the ground that it "did not demonstrate that the products were actually contaminated or that the publicity provision of the policy was triggered." The court agreed with the insurer and granted its motion for summary judgment. Because the FDA found that the peanuts were contaminated when Caudill Seed purchased them, the court concluded that the impairment of the peanuts did not occur "during the manufacture, blending, mixing, compounding, packaging, labeling, preparation, production or processing of the Named Insured's PRODUCTS" as the policy required.

Given these recent decisions, policyholders seeking coverage for contamination claims and product recalls must pay careful attention to the language of their policies. Companies concerned about these risks should work with experienced insurance coverage counsel to negotiate policy language and carvebacks to exclusions to eliminate hidden policy exclusions that might defeat coverage when their business needs it.

King & Spalding lawyers work closely with our clients and their risk managers to ensure their insurance affords adequate protection in the event of claims and assist our clients in recovering from their insurers for any losses.