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SPECIAL SECTION: FOOD & BEVERAGE

Bringing Home the Bacon: Emerging Issues in Food Insurance Law

Understanding the essentials of food contamination insurance

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Outbreaks of food contamination, most recently Chipotle's E. coli outbreak, garner not only media attention but also a flood of class actions, shareholder derivative suits and criminal investigations. Contaminated food has also produced an unprecedented wave of product recalls, some of which are at the behest of the Food and Drug Administration (FDA), while many others are voluntary and prophylactic. Product recalls are very expensive, and companies have looked to their insurance companies to cover these costs. Unfortunately, insurance companies often contest such claims, sometimes successfully. As evidenced here, understanding the policy terms on which coverage often hinges is essential to obtaining insurance that will cover the risks specific to your business.

General Liability Policies

General liability policies provide coverage for bodily injury, property damage, and advertising and personal injury claims brought against the policyholder by third parties. Thus, general liability policies should provide coverage for a food company's biggest fear: bodily injury to its customers that arises from a defective food product.

As a general rule, food products do not cause property damage to consumers. Rather, food products can cause property damage to food producers and manufacturers that use the defective product as an ingredient. Consider, for example, a frozen dinner manufacturer whose product includes includes a side of contaminated broccoli in an otherwise perfectly good dinner. Depending on the facts, general liability policies may provide coverage for the property damage costs incurred as a result of the contaminated vegetable.

For example, in *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 93 Cal. Rptr. 2d 364 (Cal. Ct. App. 2000), the policyholder supplied nut clusters to General Mills to be included in cereal. The clusters contained wood splinters. The court found that the splinters caused property damage to the cereal into which they were incorporated.

Sokol and Company v. Atlantic Mutual Insurance Company, 430 F. 3d 417 (7th Cir. 2005), concerned contaminated individually wrapped packages of peanut butter that a food company placed in boxes of cookie mix. The court denied coverage and found that no property damage occurred because the peanut butter packages could be removed without further damage to the cookie mix.

Yet in *Security National Insurance Company v. GloryBee Foods, Inc.*, Civ. No. 09-1388, 2011 U.S. Dist. Lexis 27267 (D. Or. Mar. 15, 2011), which concerned contaminated peanuts that were placed into a candy, the court found that the insurance company owed its policyholder a duty to defend because the "impaired property" exclusion did not bar coverage – the peanuts could not be removed from the candy.

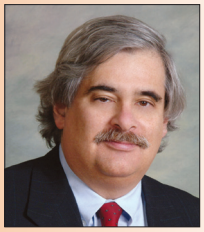
> ***Policyholders and their brokers must insist on the narrowest possible contamination exclusion.***

Thus, the key issue is whether the ingredient has been incorporated into the product to such a degree that the manufacturer cannot remove the ingredient without damage to the product.

Property Policies

Property policies, or first-party policies, protect the policyholder against damage to its own property. In the food context, such claims usually arise because of a contaminated product that the food company must destroy. Such claims are usually not covered because property policies contain broad contamination exclusions – the specific exclusion language must be carefully reviewed.

In *Leprino Foods Co. v. Factory Mutual Insurance Co.*, 653 F.3d 1121 (10th Cir. 2011), Leprino, a cheese manufacturer, suffered damage after a large quantity of cheese was contaminated in one of its third-party warehouses. The insurance policy's contamination exclusion had an exception for damage if caused by "other physical damage." The insurance company argued that there was no coverage because the cheese simply went bad. Leprino investigated the warehouse and asserted that the cheese became contaminated as a result of flavoring compounds from fruit products that



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were stored nearby in the same warehouse. The jury agreed and found coverage.

In *PBM Nutritionals v. Lexington Insurance Company*, 283 Va. 624 (Va. 2012), superheated water accidentally caused machinery water filters to disintegrate, contaminating baby food. The loss reportedly was in the millions. The court held that pollution exclusions in the relevant insurance policies foreclosed coverage. Interestingly, the original pollution exclusion in the policies contained an exception for contamination "caused by a peril insured against." The endorsements provided by the insurance companies removed this exception. This was the determinative factor on coverage.

Therefore, the policyholder must insist that its insurance broker or consultant be vigilant and craft the narrowest possible contamination exclusion.

Product Contamination Policies

No such thing as product recall insurance exists. However, product contamination policies will provide coverage for certain recalls. Principally, the policy covers product recalls necessitated by bodily injury or the likelihood of bodily injury.

A product contamination policy does not replicate the bodily injury/property damage coverage of a general liability policy. Product contamination policies solely respond to economic loss, which in the case of a product recall can be crippling. Damages can include the cost of removing the product from shelves, business interruption, and testing and disposing of the product.

One can purchase both first-party and third-party product contamination policies. A first-party policy protects against a company's internal costs incurred in addressing a recall. A third-party policy protects against claims for such expenses by third parties. Moreover, product contamination policies are not standardized; each insurance company issues its own specific form. It is incumbent on insurance brokers and consultants to seek out the best policy for your company.

Are Preventive Recalls Covered?

Policy language differs from one insurance company to another. In the context of food contamination cases, one key issue is how policies address the situation where the contaminated food has not yet caused bodily injury.

Certain policies use the phrase "resulted or would result in bodily injury," while others provide coverage if the policyholder "ha[s] reasonable cause to believe that the use or consumption of such Insured Products has [led] or would lead to ... [b]odily injury...." Another formulation provides coverage if consumption or use of the product "either resulted in, or may likely result, in ... [b]odily Injury."

For example, in *Little Lady Foods, Inc. v. Houston Casualty Company*, 819 F. Supp. 2d 759 (N.D. Il. 2011), the policyholder's product tested positive for listeria. Out of seven strains of listeria, only one is toxic. As a result of the positive test, the company could not ship 57,000 cases of burritos until further testing demonstrated that the listeria in the product was not the strain that could cause illness. Little Lady sought coverage, arguing that it incurred expense because it was "likely" that the burritos would cause illness.

The court disagreed. It found that since the burritos in fact did not contain the toxic strain, it was not likely that the product could cause illness. The court reasoned that while there was a likelihood that the product was contaminated, the operative question was the likelihood that the contaminant it contained was dangerous.

In *Hot Stuff Foods, LLC v. Houston Casualty Company*, 771 F.3d 1071 (8th Cir. 2014), Hot Stuff discovered that it misbranded Sausage Breakfast Sandwiches as MSG free when they actually contained MSG. Although there were no reported incidents of illness, Hot Stuff sought coverage under a malicious product tampering/accidental product contamination policy. The court analyzed the operative coverage language – a recall "in which consumption of the contaminated or mislabeled product 'resulted, or may likely result' in physical symptoms of bodily injury, sickness or disease or death of any person." The Eighth Circuit found the term "may likely result" unambiguous and held that it presented a jury question that could not be resolved by a summary judgment motion.

Before initiating a product recall, consider your insurance policies' specific language. While the decision to ultimately recall a product may not rest on the availability of insurance coverage, access to insurance proceeds will minimize the financial impact such contamination may have on your business.

What Is an Error?

Many product contamination policies require an error by the policyholder to trigger coverage.

In *Fresh Express Inc. v. Beazley*, 131 Cal. Rptr. 3d 129 (Cal. Ct. App. 2011), the Appellate Court found that pursuant to the insurance policy, coverage existed only if there was an "insured event." An insured event consisted of "accidental contamination," which the policy defined in part as an "error" by the insured in the "manufacture, production, processing, preparation, assembly, blending, mixing, compounding, packaging or labeling ... of any [i]nsured [p]roducts" that would cause the policyholder to have a "reasonable cause to believe" that its product would lead to illness.

The FDA issued an advisory concerning the consumption of bagged fresh spinach due to a potential E. coli outbreak. As a prophylactic measure, Fresh Express recalled spinach. The Appellate Court found that the recall was not the result of any error by Fresh Express but was the result of the general FDA advisory on contamination of spinach. The court denied coverage.

In *Foster Poultry Farms, Inc. v. Certain Underwriters at Lloyd's*, Civ. No. 1:14-953, 2016 U.S. Dist. LEXIS 17182 (E.D. Ca. Feb. 11, 2016), the court found coverage under similar policy language for a limited period of time. The policy provided coverage for "Accidental Contamination": an "'error' in the production ... use or consumption" that "would lead to bodily injury." The court found that the policy required "something less than an absolute certainty of bodily injury or sickness." Rather, bodily injury or sickness must be likely or reasonably probable in order to trigger coverage.

Another curious issue has arisen with respect to the requirement that the contamination occurs during, for example, the processing, preparation or manufacturing of food. In *Caudill Seed & Warehouse Co. v. Houston Casualty Company*, 835 F. Supp. 2d 329 (2011), Caudill Seed provided peanuts to a food manufacturer, and the peanuts were contaminated. However, the peanuts had arrived at the manufacturer's plant already contaminated. The court found that there was no coverage because the contamination did not occur during the processing, preparing or manufacturing of the product.

There is often a dichotomy when it comes to obtaining insurance coverage – a policyholder may in fact have to admit a mistake or error in order to qualify for insurance. Attention must be paid to the implications of admitting wrongdoing in order to obtain insurance proceeds.

The case law addressing insurance coverage for product contamination and recalls is inherently fact specific, and it turns on the specific language in your insurance policy. In many cases, no two claims are alike. Consider whether your current policy is the best fit for your business and if there are ways to expand coverage for your specific line of work. Take the time to consider your company's specific liability exposure and understand your insurance policy before a disaster strikes by seeking the expertise of insurance professionals and brokers.