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Special Section: FOOD & BEVERAGE

Watch the Coverage Gap

Insurance for food contamination and recalls may leave liability on the table

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Many aspects of a food manufacturer's business are predictable or planned. And then there's food contamination and product recall – unanticipated events that keep a general counsel up at night. No wonder. An outbreak of foodborne illness, linked to a product – even mistakenly, for a short time, or unconfirmed – can have devastating, if not fatal, effects on a company and its brand.

Often, all entities along a product's chain of distribution are impacted by a product recall. In *Netherlands Insurance Company v. Main St. Ingredients, LLC,* an insurance coverage dispute resulted from the recall of non-fat dried milk ("NFDM") produced by Plainview Milk Products Cooperative ("Plainview"). Case No. 11-533, 2013 U.S. Dist. LEXIS 2685 (D. Minn. Jan. 8, 2013) ("Netherlands"), aff'd 745 F.3d 909 (8th Cir. 2014). Plainview sold NFDM to Main Street Ingredients, and resold NFDM to American Cereal Corporation, which incorporated the product into instant oatmeal branded under the Malt-O-Meal ("MOM") label. Plainview and MOM initiated recalls after the FDA detected insanitary conditions and salmonella at Plainview's plant, although there was no showing that Main Street's NFDM was contaminated with salmonella.

Even after an FDA recall, the insurance company denied coverage, in part claiming the NFDM did not suffer "property damage." The Eighth Circuit affirmed the district court's finding of property damage even though no factual finding was made as to whether the NFDM or instant oatmeal contained salmonella. The Eight Circuit reasoned, "because the dried milk was 'prepared, packed, or held under insanitary conditions whereby it may have become contaminated with filth, or whereby it may have been rendered injurious to health,' and was therefore 'adulterated,' . . . whether or not it contained Salmonella, so too was the instant oatmeal." *Id.* at *16-17. Additionally, the court reasoned that after the FDA determined that insanitary conditions existed at the Plainview plant and Plainview issued a voluntary recall, "whether or not [MOM's instant oatmeal] could be safely consumed, the instant oatmeal could not be sold 'lawfully,' 'with an assurance that [it] meet[s] certain regulatory standards.'" *Id.* at *17 (alterations in original). The Eighth Circuit further held that the insurance policy covered Main Street's loss and that no exclusions applied. This specific recall led to significant litigation, invoking numerous insurance companies' obligations to various entities along NFDM's chain of distribution.

The same NFDM product recall was at issue in *Wornick Co. v. Houston Cas. Co.,* No. 1:11-cv-00391, 2013 U.S. Dist. LEXIS 62465 (S.D. Ohio May 1, 2013), a case in which the authors represented the plaintiff policyholder, along with their Anderson Kill colleague Anna Piazza. Plainview sold NFDM to Franklin Farms East, Inc. ("Franklin Farms"), which Franklin Farms sold to Trans-Packers Services Corporation ("Trans-Packers"). Trans-Packers, in turn, used the NFDM to manufacture Dairy Shakes, which it sold to The Wornick Company ("Wornick"). Wornick used the Dairy Shakes as a component in certain varieties of its Meals-Ready-to-Eat ("MREs"), which it sells as individual rations to the United States military. A recall was initiated after inspectors discovered salmonella contamination in the Dairy Shake supply chain.

Houston Casualty Company denied coverage for Wornick's claim under its Malicious Product Tampering/Accidental Product Contamination Insurance Policy, asserting in part that Wornick's losses did not result from "Accidental Product Contamination." Unlike the Eighth Circuit, the Southern District of Ohio found that the MREs were not "contaminated" or "impaired" because Wornick did not receive product that specifically tested positive for salmonella. *Id.* at *4. The court reasoned, however, that the government's recall notices constituted "governmental publication" as defined within the policy's "publicity" provision, and therefore there was an issue of fact as to whether the government recall notices triggered insurance coverage. *Id.* at *30. Reviewing the same product recall, the Eighth Circuit's and Southern District of Ohio's analysis of the contamination illustrates the complexities of securing insurance coverage after food and beverage recalls.

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How can you make sure that you buy the right coverage and that you maximize recovery when a contamination event occurs? Here are five recommendations:

1. Work with an insurance broker who has expertise with food insurance

The "ins" and "outs" of food insurance are treacherous. Companies with significant liability exposure for foodborne illness risks have been shocked to learn after such events that they were uninsured. In the food industry, the recall of contaminated or adulterated product is considered a known risk of doing business, especially in light of the fact that the industry is heavily regulated. Therefore, companies in the food industry must purchase separate coverage for product tampering and contamination.

It is crucial to consult with an insurance broker who is intimately involved with the food insurance market. Your broker should know which new food-related insurance products are available, which insurance companies are selling them and, most importantly, the insurance company's attitude toward claims handling. There are many good insurance brokers, but only a few have the expertise in protecting food and beverage companies from food contamination risks.

2. Read and understand your insurance policy before disaster strikes

Scrutinize the language of the policy offered for sale before purchasing it. Request the specific coverage you need for food contamination or foodborne illnesses in writing. Review the coverage you have purchased yearly with your expert broker or other insurance professional to confirm that it covers what you think you bought.

After a product recall is initiated, the specific terms of the insurance policy may present different coverage obstacles based on the nature of the contamination. 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." *Id.* at 1076. 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. *Id.* at 1071. Effort must be made to understand how insurance coverage may be triggered at the time of the recall.

3. Let your insurance company know immediately at your first inkling that a foodborne illness event or recall situation is possible

A staggering number of reported court decisions address an insurance company's late notice defense.

Businesses worry that providing notice "too early" will cause adverse media attention, raise future insurance premiums or sound an unnecessary alarm within the company. Even if these negative consequences do occur (and evidence that they do is scant), the negative impact is far outweighed by the risk of forfeiting coverage with late notice. Providing notice of a claim – or even informing an insurance company of events or circumstances that might form the basis for a claim in the future – is the first step in protecting your company from potential financial ruin.

> *The "ins" and "outs" of food insurance are treacherous. It is crucial to consult with an insurance broker who is intimately involved with the food insurance market.*

4. Cooperate with your insurance company, but protect your interests

Every insurance policy requires policyholders to "cooperate" with their insurance company. This makes sense. If the insurance company is going to do its job and provide coverage, it needs access to information, access to employees and access to the site.

When the insurance company honors its insurance policy, the "cooperation clause" presents no problems. Insurance companies, however, often use the policyholder's obligation to "cooperate" as a way to build its case *against* providing insurance coverage. When that happens, the "cooperation clause" is used as a means to draw the fox into the henhouse. Insurance companies often ask their policyholders to provide unnecessary information and unfettered access, only to build their case to deny coverage. When the policyholders balk at allowing such a large intrusion, the insurance companies will deny coverage based on a "breach of cooperation."

5. Do not take "no" for an answer

A staggering percentage of policyholders give up after receiving a denial from their insurance company. That means, despite having paid premiums year after year, policyholders forfeit that money rather than pursue insurance coverage in court. A policyholder's expectations of what its insurance policy covers are important, and when an insurance company tries to change the understanding after a loss, policyholders should consider fighting back.

Not all policyholders capitulate. In 2006, an E. coli outbreak occurred at some Taco Bell locations in the northeastern United States, causing widespread negative media attention focused on the brand itself. Taco Bell franchisees that did not experience the outbreak nevertheless suffered a large drop in sales due to the publicity surrounding the event. As a result, the franchisees that purchased the "Food Borne Illness/Trade Name Restoration" insurance policy looked to their insurance company, Lloyd's of London, to provide them with reimbursement for their losses. *Quick Service Mgmt Inc. v. Underwriters of Lloyds,* No. MID-L-4861-07, 2008 N.J. Super. Unpub. LEXIS 3234 (Law Div. June 12, 2009). Lloyd's refused, asserting that a vaguely worded "Aggregate Supplier Incident Sublimit" set at $0 precluded insurance coverage for contamination traceable to any entity that could be construed as remotely related to a "supplier" of the policyholder. The court sided with the franchisees and said that the language of the sublimit was unclear because it did not define the term "supplier," "supplier incident," or other key terms that might inform an "average policyholder" as to the scope of coverage. *Id.* at *12. The court agreed that the policyholders were entitled to the insurance coverage they thought they were purchasing. (Steven J. Pudell, along with his Anderson Kill colleague William Passannante, represented the franchisee policyholders in this case.)

Take the time to consider your company's specific liability exposure and seek the expertise of insurance professionals, brokers and litigation support when handling your company's insurance needs. At the time of procuring insurance and when renewing coverage, contemplate whether your current provider is the best fit for your business. Ensure that timely notice is provided of claims. Should your claim be denied, consider pursuing your rights under the policies at issue.