Keeping Your "Food Recall Insurance" Fresh

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INTRODUCTION

Every year, according to the FDA, the food industry experiences an average of ten recalls per week, and that figure does not even include meat products regulated by the USDA. In the past, the food industry treated recall expenses as a “cost of doing business,” particularly to the extent that recall-related losses were limited or excluded altogether by their comprehensive general liability (CGL) and property insurance policies. Now, specialty insurance products exist that may fill the apparent gap in coverage between standard CGL, first-party commercial property and business interruption insurance, and other policies. Nevertheless, coverage gaps persist, largely due to inconsistencies in drafting borne of the insurance industry’s uncertainty with respect to how much risk it really wants to bear in this space.

There is no single “food recall insurance” policy that a company can purchase. Rather, insurance coverage for losses and liabilities arising out of a food recall may be found in a conglomeration of multiple different insurance policies. These include first-party commercial property insurance, along with attendant business interruption insurance; commercial general liability (CGL) and umbrella liability insurance; specialty “recall” insurance or product contamination insurance (PCI); as well as directors and officers (D&O) liability insurance, and perhaps errors and omissions (E&O) insurance. A brief summary of the coverages provided (and not provided) by each type is set forth below.

I. PART ONE: ANATOMY OF A RECALL INSURANCE PORTFOLIO

A. Recall Coverage under CGL Policies

To the extent that a food contamination or recall incident involves illness, bodily injury, or damage to downstream customer’s products and property, the CGL policy is paramount. In the event of outbreak and damage claims against the food company, its CGL insurer would be the one to defend against suits, process claims under the policy’s medical payments provision, and otherwise respond to—and pay for—damage and injury claims.

1. Bodily Injury/Property Damage Requirement

A CGL policy typically defines the term “bodily injury” as “bodily injury, sickness, or disease.” Without a definition that expressly includes emotional distress and other non-physical manifestations of injury, a majority of courts have interpreted this somewhat circular definition as requiring that the claimant suffer an actual physical injury to trigger coverage. Consequently, “bodily injury” might not include coverage for emotional distress or “fear-of” claims when there is no associated physical effect. See Allstate Ins. Co. v. Diamant, 518 N.E.2d 1154 (Mass. 1988) (bodily injury includes only physical injuries to the body and its attendant consequences); Aim Ins. Co. v. Culcasi, 229 Cal. App. 3d 209 (1991) (emotional distress is not bodily injury under CGL policy).

In addition to bodily injury coverage, CGL insurance also covers liability for property damage incurred by downstream customers in the food supply chain. The typical CGL definition of “property damage” includes...

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1 See U.S. Food and Drug Administration. List of Recalls of Foods & Dietary Supplements, available at https://www.fda.gov/Safety/Recalls/default.htm#additional-info (listing seven to fourteen recalls per week since January 20, 2017, and noting that “Not all recalls have press releases or are posted on this page.”).
2 Specimen policy forms are too voluminous to attach hereto but are available upon request.
3 Other types of insurance coverage might also be available for certain recall-related losses and liabilities, e.g., marine cargo, professional liability, “Tech E&O” and others. Because of the paucity of relevant case law, a discussion addressing these and other coverage types is beyond the scope of this paper.
“physical injury to or destruction of tangible property, including consequential loss of use thereof” and “loss of use of tangible property which has not been physically injured or destroyed.”

Courts have found coverage for “property damage” under CGL insurance in multiple instances. For example:

- Coverage was allowed where faulty flavoring ingredients contaminated a finished food flavoring company’s products.⁴
- Coverage was allowed where nut clusters containing wood splinters were incorporated into a customer’s breakfast cereal product.⁵
- Coverage was allowed where benzene had contaminated carbon dioxide incorporated into soft drinks;⁶ and where trace amounts of food grade propylene glycol had contaminated orange juice.⁷ Similarly, some courts have found covered “property damage” where the contamination resulted in “loss of use” rather than physical damage.⁸

On the other hand, courts have found no covered “property damage” where contamination occurred in the policyholder’s “own work” or “own product” rather than the property of its customer.⁹ For example:

- Court found economic loss instead of “property damage” where the finished product was indeed contaminated, but the soft drink bottler’s faulty process constituted a breach of contract or warranty rather than “property damage” to a third party.
- Court found no “property damage” or “impaired property” where a policyholder’s individually sealed packets of peanut butter were found to be rancid, but were able to be removed from a customer’s cookie mix boxes without damaging other ingredients, because “[t]he paste was sealed in individual packets and those packets were simply removed from the boxes of cookie mix.”¹⁰
- Court found no “property damage” where defective cans were used to package Del Monte fruit, and Del Monte disposed of the fruit as well as the cans, because “[t]he parties do not dispute that there was no actual physical damage to the fruit itself that caused an alteration in appearance, shape, color, or other material dimension.”¹¹ The court also refused to find that the disposal of the fruit cups amounted to a "loss of use."

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Further, even where a faulty ingredient has clearly been inextricably incorporated into a product, rendering the finished product unsaleable, at least one court in Wisconsin has found that the mistake did not cause “property damage,” instead characterizing the finished product as a combination of the faulty ingredient with other ingredients to create an “integrated system.” As such, according to the majority, no “other property” (separate from the supplier’s faulty ingredient) had been damaged.  

2. CGL Exclusions

Depending on the nature of the claims, however, insurers might refuse to cover certain liabilities, based on certain exclusions.

a. The “Recall” or “Sistership” Exclusion

At first glance, the standard CGL insurance policy would appear to exclude coverage for recalls, based on the “recall” or “sistership” exclusion. This exclusion typically bars coverage for:

- Damages claimed by you for any loss, costs or expenses incurred by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of:
  
  - (1) “Your product”;
  
  - (2) “Your work”; or
  
  - (3) “Impaired property”;

  if such product, work, or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or dangerous condition in it.

This exclusion is not as straightforward as it might seem. Most courts have applied the exclusion to bar coverage for damages resulting from the insured’s withdrawal of its own product from the market. However, courts have allowed coverage, finding the exclusion inapplicable, when recall-related costs are claimed against the insured as an element of third-party damages.  

The seminal case involving the recall exclusion is *Thomas J. Lipton, Inc. v. Liberty Mutual Insurance Co.*, which involved contaminated noodles supplied to Lipton for dry-soup mixes. Lipton recalled its soups and sought damages against the noodle manufacturer for its recall-related expenses. In distinguishing between a recall of the insured’s products and a recall of the customer Lipton’s products, the New York court observed that Lipton’s recall-related damages “would usually be some of the largest foreseeable

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12 *Wis. Pharmacal Co. v. Neb. Cultures of Cal. Inc.*, 876 N.W.2d 72 (Wis. 2016). The dissent did not accept this characterization, arguing that CGL policies expressly allow coverage for damage involving “integrated systems” through the policies’ exception to the “impaired property” exclusion. Id. at 98 (¶¶ 141-143) (Abrahamson, J., dissenting). For further discussion of the “impaired property” exclusion, see Section I.A.2.c., below.


elements” of damages that would be claimed against a supplier. Accordingly, such damages related to property damage claims that were not barred by the recall/sistership exclusion.

b. The “Your Product” and “Your Work” Exclusions

The "your work" and "your product" exclusions apply to coverage for "'Property damage' to 'your product' arising out of it or any part of it," and "'Property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard.'" In the product recall or contamination context, courts have applied these exclusions to bar coverage for the cost of the policyholder's ingredient or the cost of repairing the policyholder's product, but not for the cost of other kinds of property damage caused by the policyholder's product. For example:

- In *Tradin Organics*, the policyholder sold its raspberry crumble to a food company in Canada. After the food company accepted delivery, the crumble was discovered to contain plastic, glass, and other objects, and the Canadian government ordered it recalled. The policyholder compensated its customer for the contaminated crumble and then sought coverage from its insurer for the payment. The court determined that the "your product" exclusion unambiguously barred coverage.16

- In another case, a dead mouse was found in the hose leading from the policyholder’s milk truck to its customer’s storage silo. The court held that the "your product" exclusion barred coverage for the loss of the milk, which was the policyholder’s own product, but did not apply to the cost of cleaning the customer's silo.17

- Similarly, in *Hartog Rahal Partnership v. American Motorists Insurance Co.*,18 the court distinguished between the cost for damage to the policyholder's product and other costs. There, the policyholder sold a juice concentrate to manufacturers that used it in their products advertised as one hundred percent juice. The customers' products could not be sold after it was discovered that the juice concentrate contained an artificial sweetener. The policyholder settled with its customers, and the insurer agreed to reimburse the policyholder for 80% of the settlement amount, but argued that the remaining 20% represented the cost of the policyholder's product to the customers. The court agreed.19

- The outcome in *Holsum Foods Division v. Home Insurance Co.* was similar.20 Holsum, the policyholder, manufactured and packaged barbecue sauce using ingredients supplied by its customer. It then shipped them from its warehouse at its customer's direction. After glass chips were discovered in some of the bottles, the bottles had to be destroyed and Holsum paid its customer for the costs of the destroyed product. The court held that the barbecue sauce was Holsum's product which was excluded by the "your product" exclusion:

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15 Id. at 39.
19 Id. at 332. The court did not discuss or evaluate how the discounted percentage was calculated.
We conclude that Holsum was manufacturing a product. Holsum was provided with someone else's ingredients to be sure. However, Holsum then provided an ingredient of its own, did the mixing and cooking, and created a tangible item -- the barbecue sauce.21

In both Hillside and Holsum, the policyholder manufacturers provided multiple ingredients to the finished product and performed work that resulted in the production of the final product. Thus, because the finished product was deemed to actually be the policyholder’s “own product” or “own work,” and not damaged third-party property, it was excluded.

c. The Impaired Property Exclusion

“Impaired property” is a defined term in the CGL policy. It means third-party property (not “your product” or “your work”) that cannot be used or is less useful because it has incorporated into it a defective or adulterated component and that property can be restored to use by the repair, replacement, adjustment or removal of “your product” or “your work,” or by your fulfilling the terms of the contract or agreement with the aggrieved party.22

The exclusion for “impaired property” bars coverage for such damage or loss of use; however, the “if” clause creates an important exception: if the property cannot be restored to use by removing or repairing the insured’s defective or contaminated product, then the exclusion does not apply.

The first step in determining whether this exclusion applies is deciding whether the injured property is "impaired." Where a defective component, like the peanut butter packets in Sokol, could be removed from the customer’s boxes of cookie mix and replaced without damaging the other ingredients in the mix, the policyholder’s spoiled products were “impaired property.” Accordingly, the claim fell squarely within the exclusion, because the customer’s product could be—and was—“restored to use” by removing the defective products.23

This exclusion is not in play if the third party's property has suffered "physical injury." The exclusion also does not apply if adulterating or contaminating ingredient cannot be removed from the third party's property in order to restore it. In Shade Foods, for instance, the nut clusters were not "impaired property" because it was not possible to remove the contaminated almonds. As the court noted:

[The insurer] has presented no evidence that the contaminated products manufactured from the diced almonds could be 'restored to use' by removal of the wood splinters. Indeed, it is fanciful to suppose that the nut clusters composed of congealed syrups and diced nuts or the boxed cereal product containing the nut clusters could be somehow deconstructed to remove the injurious splinters and then recombined for their original use.24

Finally, as noted by the dissent in Wisconsin Pharmacal, discussed above, the impaired property exclusion’s proviso regarding damage that can be remedied by “repair, replacement, adjustment or

21 Supra note 20, at 569. See also Nu-Pak, Inc. v. Wine Specialties Int’l Ltd, 643 N.W.2d 848 (Wis. Ct. App. 2002) (applying the "your product" exclusion to a freezable alcoholic beverage, where the policyholder mixed and packaged the product with ingredients provided by the manufacturer).

22 CG 00 01 12 07, supra note 1, definition V.8.

23 Supra note 10, at 422.

24 Supra note 5, at 866.
removal of ‘[the insured’s] product’ or ‘[the insured’s] work,” should operate to restore coverage if the property cannot be so remedied. In other words, once a faulty ingredient has been blended with a third party’s ingredients and cannot be removed from the integrated product, coverage should be preserved, not excluded, by this policy provision.

d. The “Fungi or Bacteria” Exclusion

Some CGL policies now contain an exclusion for “fungi or bacteria.” Originally intended to address toxic mold-related property damage claims, the exclusion typically contains an exception for a “good or product intended for [bodily] consumption.” Nevertheless, some insurers have tried to use the exclusion to deny coverage for bacteria-related claims against food companies.

Relatedly, to the extent that insurers may have tried to use pollution exclusions to bar CGL coverage for food contamination claims, those attempts have been unsuccessful, at least judging by the dearth of case law on the subject.

3. “Additional Insured” Coverage

When multiple companies in the food supply chain are implicated in bodily injury or property damage claims, “additional insured” coverage may be in play. A full analysis of “additional insured” issues and case law is beyond the scope of this paper; however, policyholders and insurers should be aware of the following practical considerations:

- The extent to which per-occurrence and aggregate limits of liability might reduce the overall amount available to multiple claimants under a single policy;
- The priority and effect of “other insurance” clauses on claims by purported additional insureds that have their own liability insurance;
- Which company’s primary insurer should (or wants to) take the lead on handling the crisis;
- Whether separate adjusters should be retained for multiple additional insureds under the same policy.

In addition, lawyers for insurers and policyholders must carefully navigate potential conflicts of interest that might arise in the “additional insured” context, which may involve multiple companies insured under the same insurance policy, and/or the same insurance company insuring multiple different policyholders for the same contamination- or recall-related event.

B. Recall Coverage under First-Party Property Policies

First-party commercial property insurance policies protect the insured from financial loss associated with damage to property it owns. Such insurance typically covers either specific causes of loss (“named peril” policies) or all causes of loss that are not specifically excluded or limited (“all risk” policies) that result in

25 Supra note 12, at 96-98 (Abrahamson, J., dissenting).
26 See CG 21 27 04 02.
physical damage to property. In a food recall context, the physical loss is usually the actual contamination (or reasonable supposition of actual contamination) of food that remains on hand as inventory or “stock.”

Where there is covered physical damage, commercial property policies also often provide business interruption coverage for loss of business income arising from the damage and reimbursement for extra expenses the insured incurs to minimize or avoid the loss of income and return the business to its pre-recall operating status.

1. “Direct Physical Loss or Damage” Requirement

Property insurance policies typically require “direct physical loss of or damage to” property to trigger coverage for property damage. “Physical loss” and “damage” are not defined terms. Many courts have ascribed the terms broad meaning, and have not limited them to structural damage or unfitness for human consumption. For example, courts have found that “physical damage” exists in the following circumstances:

- Pillsbury’s cream-style corn product was deemed physically damaged where spoilage could occur from potentially unsafe processing, even though there was no showing that the food actually was spoiled.29

- A Virginia ham wholesaler’s destruction of its entire lot of ham that had been exposed to ammonia was covered as a total loss, even though only some of the ham posed a potential health hazard.30

- Beans imported from Europe and treated with a pesticide not approved in the U.S. were “damaged” because they were not marketable under U.S. regulations even though they were not unfit for consumption.31

- A contractor’s use of a harmless but unapproved pesticide on oats to be used in General Mills’s Cheerios® was “property damage” even though the pesticide did not render the oats unfit for human consumption.32

All that was required in these cases was that the property be “injured in some way.”33 As the court in the General Mills case reasoned, “The business of manufacturing food products requires conforming to the appropriate FDA regulations. Whether or not the oats could be safely consumed, they legally could not be used in General Mills’ business.”34 Thus, the loss was covered property damage.

In contrast, a government embargo may not constitute “property damage.” This is what happened with the U.S. “mad cow” ban on Canadian beef in 2003. A Canadian beef producer whose cattle were not diseased was nevertheless subject to the embargo. A customer in the U.S. who made oils and shortening from beef tallow argued that he suffered a direct physical loss because his supply of Canadian beef was

28 ISO Form CP 00 10 04 02 (2002).
30 S. Wallace Edwards & Sons, Inc. v. Cincinnati Ins. Co., 353 F.3d 367 (4th Cir. 2003) (noting that had all of the ham not been discarded, USDA would have recommended a recall).
31 Blaine Richards & Co. v. Marine Indem. Ins. Co. of Am., 635 F.2d 1051 (2d Cir. 1980).
33 Id.
34 Id.
treated as though it were physically contaminated. The court held that this producer’s loss was caused solely by the ban order, not by contamination, and so it was not covered.35

2. Business Interruption

Business interruption insurance provides coverage for lost “business income” during the length of time needed to restore damaged property. A critical feature of business interruption insurance is that it does not stand alone: business interruption losses must be tied to property damage. A typical policy wording states: “the suspension [of the business] must be caused by direct physical loss of or damage to property.” Key coverage issues entail (a) what property was physically damaged, (b) whether the “suspension” of business was total or partial, and (c) the duration of the interruption and the associated restoration period.

a. Which or Whose Property Damage

Many policies require that the damage occur to property “at the premises described in the Declarations.”36 It is important to examine the policy to determine exactly which or whose property must be damaged in order to trigger the business interruption coverage.37 For example, after a restaurant was required to shut down due to an offsite sewage leak that led to E. coli contamination of an onsite well, the insurer argued that the sewer leak was not “damage to covered property” because it did not occur “at the described premises.” The court allowed coverage, holding that the closure of the restaurant “resulted from direct physical damage to the property at the insured premises” and that “[d]amage to ‘covered property’ is not required by the terms of the policy to trigger coverage of loss of business income.”38

b. Total or Partial Suspension

Some insurers have argued that the policy’s coverage of “the necessary suspension of your ‘operations’”39 requires a total suspension or cessation of the business, as opposed to a partial shutdown.40 Until ISO’s addition of a broader definition to its business interruption forms, “total cessation” had been the rule under most states’ laws under policies that do not define the term “necessary suspension.” In recent

35 Source Food Tech., Inc. v. U.S. Fid. & Guar. Co., 465 F.3d 834 (8th Cir. 2006).
36 ISO Form CP 00 30 04 02. Many policies do not expressly require the damage to occur to “covered property.” The differences among “property,” “property at the described premises” and “covered property” are important, because policyholders may claim business interruption losses as a result of damage to or destruction of someone else’s property.
37 Examples of the “which property” problem arose after the 2001 destruction of the World Trade Center, when numerous businesses in the “Ground Zero” area of New York made business interruption claims even though their businesses suffered no physical damage. Coverage depended on a number of factors, including which damaged property had to be linked to the business interruption. Compare, e.g., Royal Indem. Co. v. Retail Brand Alliance, Inc., 822 N.Y.S.2d 268 (N.Y. 2006) (allowing business interruption coverage to retail store across the street from World Trade Center but only until store reopened in 2002 and not until WTC is rebuilt), with Zurich Am. Ins. Co. v. ABM Indus., Inc., No. 01 Civ. 11200, 2006 WL 1293360 (S.D.N.Y. May 11, 2006) (allowing business interruption coverage until WTC is rebuilt for company that provided janitorial and engineering services to World Trade Center, even though towers were not owned by policyholder).
39 ISO Form CP 00 30 04 02 (2002 business interruption and extra expense coverage form).
years, however, ISO has added a definition of “suspension” to clarify that partial interruptions and slowdowns are covered as well as total cessations of business.\(^{41}\) Thus, it is important to know which language the policy contains.

c. Duration of Business Interruption

Most policies limit business interruption coverage to a set “period of restoration,” usually defined to begin 72 hours after the physical loss and to end when the property “should be” restored or when operations resume at a new location.\(^{42}\) When the suspension of business operations is shorter than the period of restoration (for example, if a business can operate temporarily at a different plant while the damaged one is being restored), no issues should arise. But when the suspension of operations extends beyond the restoration of the damaged property (for example, if the plant has been restored but customers have moved elsewhere in the meantime), the insurer might resist coverage. For example, in *Brand Management, Inc. v. Maryland Casualty Co.*, involving listeria contamination at a sushi plant, the plant closed for 15 days to disinfect the premises, but its largest customer refused to purchase from the company unless it moved from the premises. The insurance company denied coverage for any losses after the plant was disinfected, and a court agreed.\(^{43}\)

3. Exclusions

When analyzing a commercial property policy for “food recall” coverage, one should look for at least three exclusions, which insurers might raise in a food recall situation: the “contamination” exclusion, the “virus or bacteria” exclusion, and the “governmental action” exclusion.

a. Contamination Exclusion

Most first-party property policies exclude losses caused by contamination or pollution. Unlike liability insurance, commercial property policies have been the subject of a large body of case law interpreting pollution exclusions in the context of food contamination and recall claims. Court rulings have been inconsistent as to whether insurance is meant to exclude only industrial or environmental pollutants or is broad enough to exclude virtually any foreign substance.

Some courts have barred first-party coverage based on the pollution exclusion:

- The contamination exclusion was applied to preclude coverage for dressed poultry contaminated by heptachlor, a banned insecticide.\(^{44}\)
- The pollution exclusion was applied to preclude coverage for *Listeria* contamination of a sandwich processor’s products. The court found the bacteria to constitute a “pollutant,” notwithstanding

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\(^{41}\) The most recent ISO business interruption form includes a definition of “suspension” as “the slowdown or cessation of your business activities…” CP 00 30 04 02. Pre-2001 versions of ISO’s business interruption insurance form did not contain a definition of "suspension" and thus were subject to debate -- and lawsuits -- over the term’s meaning.

\(^{42}\) An ISO form states: “on the earlier of: (1) the date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality; or (2) the date when business is resumed at a new permanent location.” ISO Form CP 00 30 04 02; see *Pennbarr Corp. v. Ins. Co. of N. Am.*, 976 F.2d 145, 153 (3rd Cir. 1992).


the policyholder’s argument that the exclusion was only meant to exclude industrial pollutants and other inorganic substances.45

Other courts have allowed first-party coverage notwithstanding the exclusion:

• The contamination exclusion was not applied, and coverage was allowed, where plastic screening ended up in a pre-mix for Pillsbury biscuits. The court found the plastic was not a contaminant, disagreeing with the insurer’s theory that “almost any substance or foreign object qualifies as a contaminant.”46

• The contamination exclusion was not applied, and coverage was allowed, where contaminated ingredients caused an off taste in soft drinks. The court reasoned that the “pollution and/or contamination” exclusion was “directed to environmental pollution, and not product contamination.”47

• As explained by one court, agreeing with the narrower view of the exclusion, “[T]he unreasonableness of [the insurance company’s] interpretation becomes clear when its full implications are considered. Virtually any substance can act under the proper circumstances as an ‘irritant or contaminant.’”48 That court deemed such a reading of the exclusion to be overly broad.49

Where contamination exclusions contain an exception for losses “directly resulting from other physical damage not excluded by this Policy,” some courts have found coverage for contamination resulting from “otherwise covered” perils.

• Coverage was allowed when millions of pounds of Leprino cheese, which was stored in a third party’s warehouse, took on an “off” smell given off by fruit products stored in the same warehouse. After trial, the appeals court affirmed a jury verdict that the policy’s contamination exclusion did not apply, because the loss was caused by “some event or condition other than mere storage of other food products with its damaged cheese,” i.e., the warehouse operator’s negligent spillage and damage of fruit products that gave off odors, which in turn damaged the cheese.50

• Coverage was allowed when one million cases of Nabisco products were contaminated by chemicals present at a new warehouse where the products were stored. The court reasoned that “the actions of a third party,” which included the construction company’s failure to seal and clean up chemicals it used, were “classic ‘perils’ covered by an ‘all risks’ policy.”51

49 Id.
50 Leprino Foods Co. v. Factory Mut. Ins. Co., 653 F.3d 1121 (10th Cir. 2011). Also of interest in the court’s opinion was a reduction in the damage amount awarded to Leprino. During the course of the insurance litigation, Leprino reached a settlement with the warehouse that had stored the cheese and fruit products. The court allowed the insurer’s payment to be offset by the amount of the warehouse settlement, in order to avoid a “double recovery” for the same damage.
Exceptions to exclusions must be read carefully. At least one court has reached the opposite conclusion about the contamination exclusion, based on a somewhat different carve-out in the policy language:

- The contamination exclusion was applied to bar coverage for contaminated HoneyBaked® ham products, notwithstanding the policyholder’s argument that a roller in its conveyor system harbored the bacteria that eventually made its way to the ham, and thus it was the roller, not the contamination, that caused the loss.\(^{52}\) Importantly, the court distinguished \textit{Leprino} based upon the policies’ differing policy language: in \textit{Leprino}, the policy contained an exception for other causes of the loss, whereas in \textit{HoneyBaked}, the policy contained an exception for ensuing losses that occurred as a result of the initial contamination.\(^{53}\)

\textbf{b. Fungus, Rot and Bacteria Exclusion}

A related commercial property insurance exclusion is the exclusion for the “presence, growth, proliferation, spread or any activity of fungus, wet or dry rot or bacteria.”\(^{54}\) Policy definitions of “fungus” include mold and mildew.\(^{55}\) Like its liability insurance counterpart, this exclusion was initially designed to limit coverage for mold-related claims. To our knowledge, commercial property policies do not contain the same carve-out for products intended for consumption.

Instead, like pollution and contamination damage, discussed above, mold damage may nevertheless be covered under a first-party property insurance policy if the exclusion carves out mold-related losses that were themselves caused by an insured peril. Thus, for example, in \textit{Bruce Oakley, Inc. v. Farmland Mutual Insurance Company}, a case involving soybeans that developed mold and then auto-oxidized, the court held that the damage was actually caused by the heat that the fungus generated (heat and fire were covered perils), and coverage was allowed.\(^{56}\)

Mold coverage also may be added by endorsement, although such coverage is often sublimited to such an extent that it is arguably not worth the cost.

\textbf{c. Governmental Action Exclusion}

Commercial property insurance policies also typically contain an exclusion for damage caused by government seizure or detention. Governmental action occurs frequently in food contamination cases, \textit{e.g.}, when the FDA mandates a recall or prohibits shipment of a product. In many cases, the recalled product is destroyed or otherwise rendered unusable.

In \textit{Townsends of Ark. v. Millers Mut. Ins.}, \textit{supra} note 44, the federal court in Delaware concluded that, since neither the FDA nor the USDA ordered Townsend Farms to close its poultry slaughtering operations due to heptachlor residues found in the chickens, the “governmental action” exclusion relied on by the insurer did not apply. Since no governmental body ordered the seizure or destruction of property, the court

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\begin{enumerate}
  \item \textit{Id.} at 748-49. Notwithstanding policy language to the contrary, the \textit{HoneyBaked} court left open the possibility that the insured might still be covered for its loss under the “reasonable expectation of the insured” doctrine. Unsure as to whether Ohio had adopted such a doctrine, the court instructed to parties to propose questions on this issue for certification to the Ohio Supreme Court, \textit{Id.} at 752; however, the Ohio Supreme Court declined to answer the certified question. \textit{HoneyBaked Foods, Inc. v. Affiliated FM Ins. Co.}, 947 N.E.2d 681 (Table) (Ohio 2011).
  \item See, \textit{e.g.}, ISO Commercial Property Policy Form CP 10 30 06 07, exclusion B.1.h.
  \item See, \textit{e.g.}, ISO Commercial Property Policy Form CP 10 30 06 07, definition G.1.
  \item 245 F.3d 1027 (8th Cir. 2001).
\end{enumerate}
concluded that the claimed loss did not result from the enforcement of a statute and therefore the law/ordinance/regulation exclusion did not apply. (The court nevertheless barred coverage based on the contamination exclusion.)

C. Recall Coverage under D&O Policies

Directors and Officers (D&O) liability insurance is designed to cover certain types of financial losses. Accordingly, D&O policies typically contain exclusions for a whole host of claims that could relate to food contamination and recall incidents, such as illegal acts, intentional misconduct, punitive damages, fines and penalties, bodily injury, property damage, professional liability, and contamination. Notwithstanding these exclusions, coverage is available under D&O insurance for certain types of contamination and recall-related liabilities.

First, some D&O policies may cover the costs of a criminal investigation arising out of a food contamination issue. The successful prosecution of the Peanut Corporation of America and its executives, 57 related to the massive PCA recall and subsequent investigation, may have inspired the criminal investigation of executives of several other companies, including Chipotle and Blue Bell Creameries. In at least one case, involving the Quality Egg salmonella outbreak, executives were fined and jailed. 58 In a grand jury investigation of a food company, under the “Park Doctrine,” 59 violations of the Food, Drug, and Cosmetic Act were asserted. These violations can be strict liability offenses for corporate executives; criminal intent is not required to support a misdemeanor conviction. Although D&O policies typically exclude intentional misconduct, actions that stop short of intentional conduct but nonetheless result in an investigation—or even a conviction—might be covered by D&O insurance depending on the wording of the policy.

Second, D&O insurance might provide protection against shareholder suits to the extent that a food contamination and recall adversely affects the company’s stock value. D&O policies typically exclude suits against food company executives for claims of “…bodily injury and property damage.” However, under some D&O policy wordings this would not necessarily bar coverage for secondary claims by stockholders who sustain financial loss resulting from (or “because of” or “related to”) the bodily injury or property damage of others.

At a minimum, D&O insurance may provide coverage for defense in situations involving investigations of or shareholder derivative suits against executives, depending upon the wording of the policy. Because having access to a defense is so important, policyholders should seek to eliminate any policy provision,

57 In 2014, a jury found former PCA owner Stewart Parnell guilty on 67 federal felony counts, including felony charges of introducing adulterated food into interstate commerce “with the intent to defraud or mislead,” stemming from the 2008 salmonella outbreak that sickened 714 people and left 9 dead. The jury found Parnell covered up information and falsified documents. In 2016, Parnell was sentenced to 28 years in prison, the toughest penalty ever for a corporate executive in a food illness outbreak.


59 The U.S. Supreme Court specifically noted that the focus of criminal liability under the FDCA is not due to a corporate officer’s position within the company, but is determined by whether the officer had “by reason of his position in the corporation, responsibility and authority either to prevent it in the first instance or promptly to correct the violation complained of and that he failed to do so.” United States v. Park, 421 U.S. 658 (1975). This is known as the “Park Doctrine.”
common in some insurers’ D&O forms, that would allow the insurer to recoup its defense costs in the event that the policy ultimately is found not to provide coverage.60

D. Recall Coverage under E&O Policies

Food-related bodily injury lawsuits often include every company involved in the supply chain, up to and including farmers and growers. In addition, processors, formulators, packagers, shippers, and even food safety audit firms may be pulled into such litigation. To the extent that a recall is precipitated by a processor’s or other service provider’s faulty work, that company should have professional liability or errors and omissions (E&O) insurance to cover liabilities arising out of its professional services, as opposed to its products, which might otherwise be precluded by the “your product,” “your work” and related CGL exclusions.61

For example, E&O insurance provided a defense to a food safety audit firm that was accused of negligence in performing a “food safety” audit, which allegedly led to the sale of Listeria-contaminated cantaloupe and the subsequent injuries and deaths of consumers.62 The audit firm, Primus Labs, had given Jensen Farms a “superior” rating shortly before the facility was found by the FDA to be the source of a multistate outbreak of Listeria monocytogenes. Primus Labs did not produce a product, but its audit services created a duty to consumers to ensure that Jensen Farms cantaloupe was safe for human consumption, a service that was covered by the firm’s E&O insurance.63

E. “Recall” Coverage under Product Contamination Insurance and Other Specialty Policies

Although product recalls have been around since the Tylenol tampering incident of the 1980s, product recall insurance is still a relatively new and non-standardized type of coverage. Specialty insurance policies created and developed to address product contamination and recall issues have evolved extensively over the past 15 years. Modern versions of product contamination insurance (PCI) provide coverage for a variety of costs related to contamination incidents, including first-party coverages as well as, sometimes, third-party coverages and coverage for crisis management costs. Further, the popularity of product contamination insurance has created a market for expanded coverage offerings, including “product recall” policies, which differ somewhat from product contamination insurance, and which might respond to a recall occasioned by the determination that there is a threat, whether or not anyone has actually been harmed and whether or not there has been actual contamination.64

60 See Protection Strategies, Inc. v. Starr Indem. & Liab. Co., No. 1:13–CV–00763, 2014 WL 1655370 (E.D. Va. April 23, 2014) (although a defense was provided in response to a criminal subpoena from the NASA Office of the Inspector General, the federal court in Virginia, citing Fourth Circuit precedent, found that the insurer was entitled to recoupment of all defense costs since the insured was not entitled to coverage for the “loss” and the D&O liability policy included a reimbursement of costs provision).

61 E&O coverage might have provided some relief to the policyholders in the Hillside Bottling case, discussed above, where general liability coverage was disallowed because the company had been providing a service, not a product that caused property damage, and losses due to the faulty work were excluded by the “your work” exclusion. See, e.g., Hillside Bottling, (barring coverage under CGL policy for bottling operations that constituted policyholder’s “work”).


63 Unfortunately, Primus’s E&O policy had only $5 million in eroding limits, which was almost entirely exhausted by defense costs.

64 For example, ISO’s 2013 Product Withdrawal Coverage Form promises to pay for “product withdrawal expenses” because of a “product withdrawal” ordered by the government or deemed necessary by the policyholder. “Product withdrawal” is defined as a product recall “because of known or suspected ‘defects’ in ‘your product,’ or known or suspected ‘product tampering’, which has caused or is reasonably expected to cause ‘bodily injury’ or physical injury
1. What Triggers Coverage under PCI or Recall Policies

What limited case law that exists involving PCI policies has focused predominantly on the trigger of coverage and, in particular, whether there was actual contamination. Recently, though, at least two cases indicate greater flexibility under policies with more policyholder-friendly language covering “government recall” and “adverse publicity” circumstances. These cases are briefly discussed below.

a. Actual Contamination

Most PCI policies provide coverage for recall-related costs when product contamination has in fact occurred, not when it is merely suspected. For example, ACE’s “Recall Plus” insurance policy form promises to reimburse for losses caused by an “insured event,” which means “accidental contamination or malicious tampering.” “Accidental contamination” in turn is defined as

any accidental or unintentional contamination, impairment or mislabeling of an insured product(s), which occurs during or as a result of its manufacture, production, processing, mixing, blending, compounding, packaging or distribution, provided that the use or consumption of the insured product(s) has resulted in or would result in bodily injury or property damage.65

None of the terms in this definition is modified by the words “suspected,” “potential,” “possible,” or even “probable.” By the definition’s plain terms, there must be contamination (period), and that contamination must have resulted in or [definitely] would – not “likely” or “probably” would – result in bodily injury or property damage.

The issue of actual versus potential contamination or injury is particularly important for companies further down supply chains, who may never receive contaminated or harmful product but are nevertheless required to conduct a product recall. One only has to review recent recall history involving products such as peanut butter or hydrolyzed vegetable protein to understand that many companies involved with the affected supply chains were only concerned with products that might have been contaminated as opposed to products that actually were demonstrated to be contaminated.

Although very few insurance coverage decisions have been rendered about modern PCI policies, to date most courts that have ruled have hewn closely to the policy language requiring actual contamination and found no coverage for suspected or potential contamination.66 For example:

- No coverage allowed for a recall of Mexican food products containing spice mix from a supplier that had recalled its mix due to possible salmonella contamination, because tests

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65 ACE Recall Plus Insurance for Consumable Products Policy Form (REC-7519 (01/13) (internal quotations omitted, emphasis added).
on the finished products came back negative, and the policy required actual contamination to trigger coverage.\(^{67}\)

- No coverage allowed for voluntary recall of meat products containing ground beef from the Westland/Hallmark Meat Company, the slaughterhouse whose operations were suspended by the U.S. Department of Agriculture (USDA) because of its now notorious use of non-ambulatory disabled cattle – or “downer” cows.\(^{68}\) The California Court of Appeal found no coverage for three reasons: (1) the policyholder had not shown that there was contamination to an insured product, only that an ingredient supplied by a third party might have been adulterated; (2) the recall was based on Westland’s failure to notify it about the “downer” cows, rather than any actual contamination or tampering; and (3) no Insured Event had taken place because the policy required injuries within 120 days of consumption and no injuries were reported.\(^{69}\)

Notably, the dissent in *Windsor Foods* protested that the majority did not properly construe the policy. According to Judge King:

> [T]he policy does not clearly and explicitly state what the majority says it does. Within the context of the present matter, the more reasonable reading of the policy is that the product, and all of its ingredients, are insured for adulteration regardless of when the adulteration occurs. Thus to the extent there are two reasonable interpretations, the policy is ambiguous and should be construed against the insurer; the summary judgment should be denied.\(^{70}\)

On the other hand, policyholders have been allowed to proceed with their claims, or have won coverage outright, in some cases that did not involve actual contamination:

- Coverage was allowed in a case involving salmonella and cockroaches found at a poultry processing plant, although there was no “conclusive evidence” that any food products would have caused harm.\(^{71}\) The court based its decision on the definition of “accidental contamination,” which included “an error in the production, processing, or preparation of any Insured Products provided that their use or consumption has led to or would lead to bodily injury, sickness, disease or death.”\(^{72}\) The court refused to interpret the policy in a way that would require the insured to market the products to see whether people got sick from consuming them. Instead, it was sufficient that FSIS had concluded the product could not be sold because it was not safe to eat.\(^{73}\)

- An insurer’s motion to dismiss was denied in a case involving an FDA advisory that prompted the voluntary recall of canned shellfish that might have been exposed to

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\(^{67}\) *Ruiz Food Products, Inc. v. Catlin Syndicate Ltd.*, 2014 WL 7243262, at *1 (9th Cir. Dec. 22, 2014) (unpublished opinion).


\(^{69}\) Id. at 1185-6.

\(^{70}\) Id. at 1190 (King, J., dissenting).


\(^{72}\) Id., slip. op. at 9.

\(^{73}\) Id., slip. op at 11-12.
norovirus due to a Korean supplier’s inadequate sanitation standards.\textsuperscript{74} The court based its decision on Tri-Union’s broad PCI policy language, covering “accidental contamination” if use or consumption of its product “would result in clear, identifiable, internal or external visible physical symptoms of bodily injury...” or if contamination caused the product to be “injurious to health or unfit for human consumption and as a result... a recall order by the competent authority is imminent in order to comply with regulations on food safety.”\textsuperscript{75}

- A case involving a Class III recall (i.e., FDA determined that use of the product would not cause adverse health consequences) was ordered to trial based on the factual question whether bodily injury “may likely result” from the consumption of breakfast sandwiches containing MSG, an undeclared allergen that prompted the recall.\textsuperscript{76}

Some “recall” policies are not limited to actual contamination events, focusing instead on the probability of contamination and injury. For example, Chubb offers recall insurance for Class 1 recalls, which are those involving a “situation in which there is a reasonable probability that the use of, or exposure to, such product will cause serious adverse health consequences or death.”\textsuperscript{77}

Similarly, ISO’s Product Withdrawal Coverage Form agrees to reimburse “product withdrawal expenses,” defined to include suspected defects:

“Product withdrawal” means the recall... of your products, or products which contain your products, because of known or suspected defects in your product, or known or suspected product tampering, which has caused or is reasonably expected to cause bodily injury or physical injury to tangible property other than your product.\textsuperscript{78}

Here, actual contamination and actual injury are not required. Instead, a defect may only be suspected. On the other hand, that defect must be “reasonably expected” to cause injury or damage. Thus, if a product is considered defective but would not result in bodily injury or property damage, coverage might not be available. Outcomes may vary depending on the terms of the policy and the “reasonableness” of the expectation of harm.

\textbf{b. Government Recall}

Some specialty policies provide coverage for a “governmental recall” in addition to or as an alternative to actual contamination. This provision requires a governmental determination that there is a “reasonable probability” that the recalled product will cause “serious adverse health consequences or death.”\textsuperscript{79}

In a recent case involving both “accidental contamination” and “governmental recall” coverage, a poultry manufacturer successfully claimed coverage for losses suffered when it destroyed millions of pounds of chicken that had not been approved for sale by the USDA, due to poor pest control and sanitation provisions at the plant, including the presence of salmonella. In addition to its denial of coverage on

\begin{itemize}
  \item Id., slip op. at 21.
  \item Hot Stuff Foods, LLC v. Hous. Cas. Co., 771 F.3d 1071, 1081 (8th Cir. 2014).
  \item Chubb Product Withdrawal and Crisis Management Insurance, Form 80-02-6427 (Ed. 8-04).
  \item Insurance Services Office, Product Withdrawal Coverage Form (CG 00 66 12 04) (internal quotations omitted).
  \item Supra note 71, slip op. at 20-21.
\end{itemize}
“actual contamination” grounds (see above), the insurer also argued that because Foster destroyed its products before sending them into the market, there was no “governmental recall” of the products. The court disagreed and found coverage under both grants of coverage.\textsuperscript{80}

The key to these findings was in the definitions. “Accidental Contamination” was defined as “an error in the production, processing, or preparation of any Insured Products provided that their use or consumption has led to or would lead to bodily injury, sickness, disease or death.” The court rejected the insurer’s contention that Foster needed “conclusive evidence” that the products would have caused harm, noting that it would not interpret the policy to require the insured to send products out to market to see whether people got sick from consuming them.\textsuperscript{81} Under this policy language, it was sufficient that USDA had concluded the product could not be sold because it was not safe to eat.

c. Adverse Publicity

In at least one case, adverse publicity was enough to trigger coverage under a PCI policy even without actual contamination. In \textit{Wornick Co. v. Houston Casualty Co.},\textsuperscript{82} the insured, \textit{Wornick}, was an assembler of “meals-ready-to-eat (MRE),” which included dairy shake packets manufactured by Trans-Packers Services Corp. As a supply-chain integrator, \textit{Wornick} purchased the component items for MREs from manufacturers, consolidated them into a final MRE package, and sold them to the Government. The dairy shake packets contained instant dried milk that Trans-Packers purchased from Franklin Farms East, Inc. who, in turn, purchased from Plainview Milk Products Cooperative.

Salmonella was found in some of the dairy shake packets at the Trans-Packers facility. As a result, the FDA began an investigation and found salmonella at Plainview’s facilities. Plainview, Trans-Packers, and \textit{Wornick} initiated recalls for the products. \textit{Wornick} then sought coverage under its Malicious Product Tampering/Accidental Product Contamination Insurance Policy, arguing that the MREs were subject to recall for failing to meet product specifications, that the MREs were impaired by the potential contamination, and that Government reports implying that the MREs were contaminated triggered coverage under the Policy’s publicity coverage. However, no salmonella was found in \textit{Wornick}’s MREs, because \textit{Wornick} never received the salmonella-tainted batch from its suppliers.

The court nevertheless found that coverage was possible even in the absence of actual contamination, under the Policy’s publicity clause. The Policy defined “Accidental Product Contamination” to include “PUBLICITY implying [contamination],” and defined “Publicity” as “[t]he reporting of an actual or alleged [accidental product contamination] . . . in local, regional or national media . . . or any governmental publication where the Named Insured’s [products] and the Named Insured are specifically named.”\textsuperscript{83}

Under those terms, the Court found that government “Do Not Consume” orders which specifically named \textit{Wornick}’s products constituted “Publicity” within the meaning of the policy, and concluded that a dispute of fact remained about whether \textit{Wornick}’s losses resulted directly from such publicity. The Court came to this conclusion despite that \textit{Wornick}’s products had not actually been contaminated, emphasizing that the Policy’s publicity definition encompassed “actual or alleged” contamination. Requiring “actual physical symptoms or physical damage in the event that there is merely publicity that implies

\textsuperscript{80} \textit{Supra} note 79, slip op. at 20-21, 24-26.
\textsuperscript{81} \textit{Id.}, slip op. at 21-22.
\textsuperscript{82} No. 1:11-cv-00391, 2013 U.S. Dist. LEXIS 62465 (S.D. Ohio May 1, 2013).
\textsuperscript{83} \textit{Id.} at *4.
contamination of the product,” the Court said, would make “the inclusion of the word ‘alleged’ ...meaningless.”

The Court ultimately denied both parties’ motions for summary judgment, finding that there were genuine issues of fact remaining as to whether there was a fault in design specification or performance amounting to an Accidental Product Contamination; whether there was a basis for Publicity coverage; and whether the insurer had acted in bad faith in denying Wornick’s claims.

2. Types of Potentially Covered Costs

Specialty insurance has also been extended to cover adverse publicity and crisis management. “Crisis management service” under the Chubb policy form, for example, includes coverage for “professional services or advice provided by a crisis management service firm in connection with a Class 1 recall.” Adverse publicity coverage involves reporting in the media or the release of a government publication where an insured or its product is identified as being involved with an insured event, such as malicious contamination. Adverse publicity and crisis management coverages may be provided as standalone coverage or as part of contamination coverage, often by amendatory endorsement, and sometimes with sublimits that cap the amount of insurance available.

The types of costs or expenses covered under specialty crisis policies usually include the costs of the recall itself (e.g., repair/replacement, disposal, notification, employee overtime, temp workers, transportation, warehousing/storage); often include related losses that result from the recall (e.g., business interruption, loss of gross profit, rehabilitation costs, redistribution, increased cost of working, product extortion/ransom costs, as well as pre-recall costs, extra expense); and may sometimes include liability for third-party costs (e.g., customer loss of gross revenue, third-party recall costs, product liability and defense costs). Specialized policy forms have not been standardized, and different insurers offer different levels and types of coverage. It therefore can be critical to involve knowledgeable brokers and risk management personnel in the insurance placement and renewal process.

Some insurance companies offer coverage for some but not all of the aforementioned loss types. For example, ISO’s Limited Product Withdrawal Expense Endorsement (a narrow CGL endorsement) is limited indeed, covering logistical costs of a recall but excluding lost profits, expenses for regaining goodwill, lost market share, or other costs of restoring and rehabilitating the product; and it also excludes third-party liability and defense costs. Similarly, Swiss Re stated in a 1998 brochure that coverage for lost profits and lost market share is available, but recommended sublimiting such coverage and “defin[ing] precisely how indemnifications of this type are to be quantified.”

Product contamination and product recall policies also might provide critical pre- and post-crisis consultant coverage. When a company faces a product crisis event, it may need a team of experts to help it survive the onslaught of customer, governmental and regulatory inquiries, intrusions and investigations. Specialty crisis policies provide companies with the ability to engage a panel of experts in public relations, governmental interaction, root cause investigation, laboratory testing, contamination identification, manufacturing or production processing and legal assistance before and after a crisis. Pre-crisis

84 Id.
85 See, e.g., ACE, Adverse Publicity Coverage Endorsement, Form REC-7546 (01/13).
86 Insurance Services Office, Limited Product Withdrawal Expense Endorsement (CG 04 36 04 13).
consultancy can assist a company with preparation for a crisis event, including the review or creation of a crisis response plan. When the event takes place, these specialty crisis policies provide a company with a hotline number used to immediately engage its team of experts. If a company begins to search for experts after a crisis event commences, it may find that its actions are too little and too late: the list of qualified experts in the field of food contamination and product recalls is quite short, and they might already be retained by other parties involved in the recall.

But insurers may seek to avoid coverage for costs they deem unrelated to the contamination or the recall, such as recall-related advertising costs that replace the company’s normal advertising expenses in the same amount. Costs and expenses related to the design or redesign of products also are typically excluded. Similarly, some policies expressly exclude costs of rehabilitating a product and regaining the company’s goodwill and brand reputation, whereas others might include such coverage by endorsement. Such brand/goodwill coverage is significant, because such losses can far outstrip the expenses associated with the physical recall itself.88

3. What [Else] Recall Policies Might Not Cover

Like all insurance, coverage under specialty contamination, recall and crisis policies is bounded by their terms, which necessarily include the policy’s definitions, conditions and exclusions. Terms vary widely from insurer to insurer and from policy form to policy form; therefore, policyholders must be diligent in reviewing and understanding what coverage they have.89

In addition to the issues described above, specialty recall policies are generally not designed to provide coverage for mere quality issues that have no bearing on the potential for bodily injury or property damage. That being said, however, certain insurers may offer product guarantee coverage for certain industries.

Like other types of insurance policies, specialty policies contain various exclusions that bar coverage for losses arising out of certain circumstances. Some specialty policies exclude coverage for third-party liability claims attributable to the use or consumption of an insured product, which would ordinarily be covered under a company’s third-party liability policy. Some policies also exclude losses attributable to circumstances involving a competitor’s product; although, coverage may be available for product refusal, regardless of the cause of the refusal.

Predictably, intentional and wrongful violations of governmental regulations or industry best practices are often excluded under specialty policies. Similarly, circumstances of which an insured had actual or constructive knowledge before the policy’s inception are usually excluded.

4. Rescission

In addition to denials based on intent exclusions, some insurers are trying to use rescission as a weapon in order to void policies ab initio on such grounds. Results have been mixed, but recent cases indicate that insurers may be gaining ground.

89 See id. (listing exclusions for losses arising out of a “known defect” (exclusion f), “pollution-related expenses” (exclusion k) and “chemical transformation” (exclusion c), among others).
In *Certain Underwriters at Lloyd’s, London v. Abbott Laboratories*, the insurers, Certain Underwriters at Lloyd’s, London, sought to rescind coverage to Abbott Laboratories based on a recall involving a weight loss drug made by a company Abbott had recently acquired. After Abbott had signed the final insurance application, but before all of the Underwriters had agreed to the terms of coverage, The Wall Street Journal ran an article regarding the possibility of an FDA recall of the acquired company’s drug. An Abbott representative advised Underwriters about the article, but did not forward a copy of it. Underwriters and Abbott eventually reached agreement as to the additional premium tied to the acquisition. Abbott then paid the premium and provided a copy of the Wall Street Journal article to Underwriters. Underwriters accepted the premium payment. Several months later, Abbott recalled the product. After Abbott sought coverage under its recall insurance, Underwriters balked and sought to rescind their policy instead.

The court found that Abbott was entitled to coverage and that the insurers had waived their right to rescission based on their knowledge of the facts and their delay in seeking rescission. The court held that an insurer who wishes to rescind a policy needs to do so as soon as they learn of the information upon which they base the rescission.

The policyholder was not so fortunate in the recent *Heinz* rescission case. In January 2017, the Third Circuit Court of Appeals allowed Starr Surplus Lines to rescind a product contamination policy it had issued to multinational food corporation H. J. Heinz Company. The insurer’s rescission was based on Heinz’s failure to disclose several recall-related losses on its insurance application, which Starr characterized as “material misrepresentations.” Heinz argued that the undisclosed prior losses were too small and too unrelated to be material to its insurance application, and that the insurer could not have relied on them in issuing the new policy with a $5 million self-insured retention. The court disagreed, holding: “Heinz’s misrepresentations were of such magnitude that they deprived Starr of its ‘freedom of choice in determining whether to accept or reject the risk upon full disclosure of all the facts which might reasonably affect that choice.’”

Less than a month later, the same insurer filed suit in New York federal court against a frozen food manufacturer involved in a listeria recall, seeking to rescind a $10 million policy. The grounds for rescission, according to Starr, were that the food company allegedly gave “false answers, omissions and concealment of material facts” involving state and federal inspections, notwithstanding that the company had corrected violations noted by inspection authorities.

Policyholders are fighting back. In March, National Frozen Foods Corp. filed suit against its insurer, a unit of W.R. Berkley Corp., seeking coverage under a contaminated products insurance policy for $3.5 million in damages due to possible listeria contamination, which resulted in a recall of approximately 470,000 pounds of frozen peas. According to the complaint, the insurer is allegedly withholding coverage because it believes National Frozen Foods was dishonest about prior recall events in its policy application.

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91 *Id.* at 756 (¶¶ 49-50).
92 *Id.* at 758 (¶53).
These cases show that insurers who underwrite specialty product recall or contamination policies are not afraid to use insurance applications as vehicles for rescission actions. Policyholders could risk having their insurance policies rescinded if they failed to disclose losses and circumstances—even small or seemingly unrelated—that relate to the type of risk for which they seek coverage later. Companies that operate in the food industry should be very cautious when completing initial or renewal applications, at the risk of becoming embroiled in litigation that could result in the forfeiture of future insurance coverage for similar claims.

II. PART TWO - PRACTICAL ADVICE FOR COMPANIES IN THE FOOD RECALL INSURANCE MARKET

In addition to the material above, the Authors will discuss at the seminar various difficult issues and practical tips that Food Recall cases present.

CONCLUSION

Any company in manufacturing, packaging or distribution of any product must consider the possibility that something could go wrong with its product, and that a recall might be necessary. Many companies choose to focus their risk management for product recalls on avoiding the necessity for such recalls in the first place, but the right insurance portfolio at the right price could be part of a prudent strategy for managing and minimizing a recall’s impact on the company’s bottom line.

Most companies already have basic coverage for certain specific types of losses under their existing CGL and commercial property insurance. Those companies desiring greater assurances with regard to recalls and contamination coverage may turn to specialty insurance policy forms, or even bespoke, manuscript policies. While the insurance industry continues to develop its coverage products to address such risks, the market’s offerings are widely disparate. To the extent that the recall insurance market has a “wild west” quality, the largest companies in the food industry might enjoy increased bargaining power. Smaller companies in the supply chain, however, might lack such advantage, particularly if their internal risk management personnel and outside insurance brokers are not up to speed on the latest developments in this area.

As case law continues to develop to clarify the scope of CGL, first-party property, and specialized insurance policies, companies must ensure that the specifics of the policies purchased are appropriately tailored to the recall risks they face, and must be prepared to navigate the terms and conditions of their coverage in the event a recall must be conducted. As the case law shows, similar facts can result in different coverage outcomes depending on policy language, and in particular definitions of the triggering events. These language differences should be carefully considered when placing or renewing this type of coverage.

Policyholders should also be attentive to the application process itself when purchasing product recall and other specialty insurance. Recent litigation indicates that, when faced with a substantial recall-related claim, insurers might look beyond triggering limitations and policy exclusions to deny coverage, potentially seeking to rescind the policy based on omissions or inaccuracies in the policyholder’s application.

With all of these concerns on the policyholder side, insurers, too, would be well advised to carefully consider the coverage products they make available in the marketplace.