

# **FOOD CONTAMINATION INSURANCE COVERAGE ISSUES: AN INSURER'S PERSPECTIVE**

**Reflecting Decisions Rendered as of March 2008**

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## I. Introduction

It seems that it is difficult to turn on the television or open a newspaper without reading about another story of contaminated food. Recent multi-state, international recalls of *Escherichia coli* (“E. coli”) and Salmonella contaminated produce in 2006 and 2007 highlight the countless examples of the widespread impact of food contamination claims in our modern, industrialized society.

Last year was catastrophic for the food industry. The year started badly when the first recall was announced on January 2, 2007. U.S. Food and Drug Administration Recall – Firm Press Release, *Ho’s Trading Inc. Recalls Home Special Health Soup Recipe (Dry Mix)*, Jan. 2, 2007. Shortly thereafter, the largest pet food contamination recall in history was announced. U.S. Food and Drug Administration Recall – Firm Press Release, *Menu Foods Issues Recall of Specific Can and Small Foil Pouch Wet Pet Foods*, Mar. 16, 2007. The year that devastated the U.S. food industry’s safety reputation continued with an All-American list of contaminated food products that involved international, national and super-regional recalls including, but not limited to: a spinach recall involving 48 states and Canadian provinces; a peanut butter recall involving 47 states; and a pot pie recall involving 31 states. Apple pie appears to have been the one American standard that was not recalled last year. Of course, any 2007 food contamination highlight film would not be complete without Topps’ recall of historic proportions, which involved 21.7 million pounds of hamburger, was the second largest ground beef recall and third largest food recall in U.S. history.

While the number of foodborne pathogens identified continues to increase, the number of foodborne illnesses reported is steadily decreasing. Even though the number of foodborne-illness cases is declining, large-scale outbreaks continue to occur. It is estimated that approximately one out of every four Americans suffers from some form of foodborne illness every year. In 2003, a Hepatitis A outbreak originated from a single location of a national restaurant chain, Chi-Chi’s, just outside of Pittsburgh, Pennsylvania, and led to more than 600 illnesses, including several deaths, from customers eating green onions. Given the increasing litigiousness of Americans, we can expect that even as the number of foodborne illnesses continues to decrease, the ultimate money paid out for both informal claims and litigated suits related to food contamination will continue to increase.

Historically, the growth and distribution of produce was the business of small, family-owned farming operations. With the advent of “big business” and the steady decline of “mom and pop operations,” the food production and distribution process has become increasingly and overwhelmingly centralized. Individual large-scale growers provide produce that may ultimately be distributed to dozens of states across the country. Simultaneously, the Country’s food supply chain has become dangerously extended through globalization, offshoring and outsourcing. The ramifications are simple and frightening. A single outbreak of contaminated produce from one grower’s crop, manufactured in one state but shipped to

multiple states, can potentially sicken people in every state in which that product is distributed. This reality, coupled with consumers' eating patterns toward more imported foods as well as processed foods sold by fast food and national restaurant chains is a recipe for potentially catastrophic losses stemming from foodborne illnesses.

The anticipated future loss scenarios from foodborne illnesses beg the obvious and glaring question – who is going to pay for these losses? Consumers sickened by foodborne illnesses may be entitled to monetary damages to compensate them for their injuries, which may range anywhere from stomach ache to death. Moreover, because the elderly and young children tend to be the most adversely affected by certain strains of bacterial and viral contaminations, these lawsuits will be emotionally charged, thereby increasing the risk of substantial jury awards.

Bodily injuries aside, there are enormous financial losses that result from any significant food recall. Once a recall is issued, the recalled product must be removed from shelves, transported and destroyed. Notices informing the public of the recall may have to be issued and distributed. Consumer refunds may also be issued. Additionally, costs may be incurred to rehabilitate a brand's reputation. Various entities in the distribution chain may lose anticipated profits. Depending on the recall's scope and the economic viability of the impacted businesses, a product recall can financially ruin a business. For instance, according to the U.S. Centers for Disease Control ("CDC"), medical costs and lost wages due to foodborne salmonellosis, only one of many foodborne infections, have been estimated to be more than \$1 billion per year.

Given the reach of potential food contamination claims such as the recent spinach, bagged salad and ground beef outbreaks, potential targets for liability may include a broad range of businesses, beginning with growers and ranchers to fertilizer manufacturers and feed distributors and continuing through packagers, distributors and shippers and ending through points of sale, such as food processors, retail markets, restaurants and caterers.

All hope is not lost for businesses involved in the food industry. Companies can purchase insurance to defray the costs and expenses associated with product recalls. Liability policies may pay for defense costs and indemnity exposure with respect to the companies' liability to others. Companies may also purchase policies for the costs associated with losses to their own assets – property policies. Additionally, the availability of specialized policies is growing. Specialized policies, such as product recall and trade disruption policies, may supplement the coverage provided by standard liability and property policies.

## II. Commercial General Liability Coverage

The Insuring Agreement in standard Commercial General Liability (“CGL”) policies provides that an insurer “will pay those sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’ to which this insurance applies.” Standard commercial general liability policies define “property damage” as:

- (1) Physical injury to tangible property including all resulting loss of use of that property; or
- (2) Loss of use of tangible property that is not physically injured.

“Bodily injury” is typically defined as “bodily injury, sickness or disease.”

### A. Property Damage

Although bodily injury claims stemming from food contamination events are more widely publicized in the press, large-scale food contamination cases also result in enormous *economic* losses to multiple parties in the product’s supply chain. Product manufacturers, growers, ranchers, feed processors, packagers, distributors and retailers can suffer heavy financial losses resulting from significant product recalls and financial losses can result in litigation between the various companies involved in the manufacture, distribution and sale of the contaminated product. Clearly, such economic loss claims do not stem from “bodily injury.” However, depending on the underlying facts, these claims may fall within a third-party liability policy’s “property damage” coverage. In other words, the economic loss claims may include allegations of “physical injury to tangible property” or “loss of use of tangible property that has not been physically injured.”

At least one court has held in the third-party liability context that the “physical injury” requirement is met where the food product is only in technical violation of U.S. Food and Drug Administration (“FDA”) regulations, but is still fit for human consumption. In *United Sugars Corp. v. St. Paul Fire & Marine Ins. Co.*, No. A06-1933, 2007 WL 1816412 (Minn. Ct. App. June 26, 2007), the Minnesota Court of Appeals applied the definition of “physical damage” previously used in a first-party property policy case, *General Mills, Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147 (Minn. Ct. App. 2001). In *General Mills*, the Food and Drug Administration found traces of a chemical that was not harmful to consumers in cereal produced by oat stocks, but that had not been approved for use on oats. *General Mills*, 622 N.W.2d at 150. Although the insurer argued that there was no “physical damage” because the cereal could be safely consumed, the court

disagreed, reasoning that “direct physical loss can exist without actual destruction of property . . . it is sufficient to show that the insured property is injured in some way.” *Id.* at 152. The court concluded that the fact that the cereal could not be legally sold was sufficient to support a finding of physical damage. *Id.*

In *United Sugar*, despite the insurer’s objections that *General Mills* involved a first-party property policy and not a third-party liability policy, the Minnesota Court of Appeals applied the *General Mills* definition of “physical damage” and held that “an adulterated food product can be deemed physically damaged because it is legally unsaleable.” *United Sugar*, 2007 WL 1816412 at \*3.

Where the policyholder’s defective product has been incorporated into another product, the majority of jurisdictions have held that the *mere incorporation* does not amount to “property damage” under a CGL policy. *Diamond State Ins. Co. v. Chester-Jensen Co.*, 611 N.E.2d 1083 (Ill. App. Ct. 1993) (mere inclusion of a defective component, where no physical harm to the other parts results therefrom, did not constitute “property damage” within the meaning of an insurance policy); *New Hampshire Ins. Co. v. Vieira*, 930 F.2d 696 (9th Cir. 1991) (insurance covering physical injury to tangible property does not cover diminution of value resulting from the installation of a defective product); *Aetna Life and Cas. Co. v. Patrick Indus. Inc.*, 645 N.E.2d 656 (Ind. Ct. App. 1995) (the concept of incorporation should not be extended so that physical injury will be deemed to occur every time a defective component is integrated into another's tangible property).

In contrast, a California appellate court has held that the incorporation of a defective product into a separate uncontaminated product may result in “physical injury” to the product into which the defective product is incorporated. *Shade Foods Inc. v. Innovative Prods. Sales & Marketing Inc.*, 93 Cal. Rptr. 2d 364 (Cal. Ct. App. 2000). In *Shade Foods*, the insured processed and supplied nut clusters to General Mills to be added to breakfast cereals. Wood splinters were discovered in the diced almonds supplied by the policyholder, resulting in the shutdown of General Mills’ production and the destruction of cereal boxes at its facilities. The court rejected the insurer’s argument that General Mills’ claims were limited to economic loss claims, and held that the presence of wood splinters in the almonds caused “property damage” to the nut clusters and cereals into which they were incorporated. *See also Zurich American Ins. Co. v. Cutrale Citrus Juices USA, Inc.*, No. 00-CV-149, 2002 WL 1433728 at \*3-4 (M.D. Fla. 2002) (holding that accidental introduction of the insured’s contaminated juice products into the claimant’s own juice products constituted a physical event that causes injury or damage); *National Union Fire Ins. Co. of Pittsburgh, PA v. Terra Indus., Inc.*, 216 F. Supp. 2d 899, 917-18 (N.D. Iowa 2002) (same).

A related issue is the limitation of property damage coverage to injury “because of . . . property damage” as required by CGL policies. This issue may be particularly relevant in light of the fact that pure economic loss, by itself, does not

amount to covered “property damage.” *McLaughlin v. National Union Fire Ins. Co.*, 23 Cal. App. 4th 1132 (Cal. Ct. App. 1994). It is widely agreed that pure economic loss claims, such as lost profits, loss of goodwill or loss of the benefit of a bargain, do not constitute “property damage.” This is so because pure economic loss is not physical injury to or loss of use of tangible property. However, some courts have strained to find property damage coverage for economic loss claims in the food contamination context. For instance, in *United States Fire Ins. Co. v. Good Humor Corp.*, the insured manufacturer recalled contaminated ice cream, causing financial loss to one of the policyholder’s customers. In the resulting coverage litigation, the court held that the customer’s loss of use of storage space from having to store the recalled ice cream was potentially a loss of use of tangible property (the tangible property being the storage space) and not a mere economic loss. *United States Fire Ins. Co. v. Good Humor Corp.*, 496 N.W.2d 730 (Wis. Ct. App. 1993); *see also Stark Liquidation Co., v. Florists’ Mut. Ins. Co.*, No. ED87852, 2007 WL 2317140 (Mo. App. E.D. Aug. 14, 2007)(coverage found for damages caused by failure of bacterially-infected apricot trees to produce fruit); *Hendrickson v. Zurich Am. Ins. Co.*, 72 Cal. App. 4th 1084 (Cal. Ct. App. 1999) (loss of strawberry production after herbicide drifted onto grower’s fields constituted a covered loss of use of the growers’ land).

## **B. Bodily Injury**

Many standard liability policies define the term “bodily injury” as “bodily injury, sickness or disease.” The majority of courts have interpreted this definition as requiring that the claimant suffer actual physical injury before coverage is triggered. *Aim Ins. Co. v. Culcasi*, 280 Cal. Rptr. 2d 766 (Cal. Ct. App. 1991) (“overwhelming majority” of courts have held that emotional distress claims do not constitute bodily injury under a liability policy); *Allstate Ins. Co. v. Diamant*, 518 N.E.2d 1154 (Mass. 1988) (bodily injury is narrow term and encompasses only physical injuries to the body and the consequences thereof). In other words, the term “bodily injury” in a liability policy does not include coverage for emotional distress in the absence of physical injury. *Id.*

It should be noted, however, that the physical injury requirement is most likely inapplicable where the policy defines “bodily injury” as “injury, sickness or disease” instead of “bodily injury, sickness or disease.” Moreover, the physical injury requirement is inapplicable where “bodily injury” is defined by the policy, in part, as emotional distress or mental anguish.

With respect to policies that define “bodily injury” as “bodily injury, sickness or disease,” there is little dispute that the claims of consumers who have ingested contaminated food products and suffer resulting physical injury, ranging from stomach ache to death, are sufficient to trigger “bodily injury” coverage under a liability policy. However, in widespread food contamination cases in which many claimants are potentially exposed to the contaminated product, the class of

claimants will frequently include individuals who have not suffered actual bodily injury, but instead allege emotional distress or fear that they will develop bodily injury in the future from exposure to the contaminated foods. Generally, “bodily injury” coverage under a liability policy requires bodily injury in the physical sense (as opposed to mental injury or distress). The majority of courts to address this issue have held that pure emotional distress claims, such as claims alleging fear of future injury, do not constitute “bodily injury” covered under a liability policy. *Aim Ins. Co. v. Culcasi*, 280 Cal. Rptr. 2d 766, *supra*; *Allstate Ins. Co. v. Diamant*, 518 N.E.2d 1154, *supra*.

With respect to underlying food contamination liability claims, some courts have held that a company’s potential liability for bodily injury extends not only to present injury claims, but to plaintiffs’ concerns about the risk of future injury. *Norfolk & W.Ry.Co. v. Ayers*, 538 U.S. 135 (2003); *Redland Soccer Club v. Dep’t of the Army*, 55 F.3d 827 (3rd Cir. 1995). In response to this potential liability exposure, at least one insurance coverage opinion has found “bodily injury” liability coverage for “fear of injury” or medical monitoring damages. This court reasoned that as long as the insured faces bona fide tort liability for claims for “fear of injury” damages or medical monitoring, a liability policy’s bodily injury coverage will apply. *Techalloy Co., Inc. v. Reliance Ins. Co.*, 487 A.2d 820 (Pa. Super. Ct. 1984).

## **C. Occurrence**

### **1. Accident Requirement**

Most standard ISO CGL forms define “occurrence” as “an accident, including repeated exposure to substantially the same general harmful conditions.” An accident, according to the majority of courts that have addressed this issue, is an unanticipated event or an unknown contingency. *High Country Assoc. v. New Hampshire Ins. Co.*, 648 A.2d 474, 474 (N.H. 1994). In analyzing the existence of an “occurrence,” a growing majority of courts have held that an insured’s defective work and/or product, by itself, does not constitute an accident under a liability policy. *Nationwide Mut. Ins. Co. v. CPB Int’l, Inc.*, 2007 WL 4198173, slip op. (M.D. Pa. Nov. 26, 2007) (claims that are contractual in nature fail to meet the “occurrence” requirement); *Jakobsen Shipyard Inc. v. Aetna Cas. And Sur. Co.*, 961 F.2d 387, 389 (2d Cir. 1992) (New York law) (faulty steering on tugboats was the result of faulty workmanship; no occurrence where there was no unknown or remote cause and no unexpected external force); *Hawkeye-Security Ins. Co. v. Vector Construction Co.*, 560 N.W.2d 329, 334 (Mich. Ct. App. 1990) (defective workmanship standing alone is not the result of an occurrence); *U.S. Fid. & Guar. Corp. v. Advance Roofing & Supply Co.*, 788 P.2d 1227, 1233 (Ariz. Ct. App. 1989) (insurer is not guarantor of insured’s performance of contract).

One of the seminal cases reflecting the view that a faulty product or workmanship is not an accident is *Weedo v. Stone-E-Brick Inc.*, 405 A.2d 788 (N.J. 1979). In

*Weedo*, the New Jersey Supreme Court addressed whether a property owner's complaint for unworkmanlike performance of a construction contract triggered coverage under a liability policy. In short, the court held that a CGL policy "does not cover an accident of faulty workmanship, but rather faulty workmanship which causes an accident." In support of its holding, the *Weedo* court reasoned that there is a moral hazard in providing liability insurance coverage for the repair or replacement of faulty workmanship or a faulty product, as the insured would have little or no incentive to perform or produce in a workmanlike manner. It appears that the court's ruling in *Weedo* represents the majority view on this issue. As such, in most jurisdictions there would be no coverage for third party contaminated food claims where the third party only alleges damages resulting from the insured's allegedly defective work and/or product.

In *Atlantic Mutual Ins. Co. v. Hillside Bottling Co.*, 903 A.2d 513 (N.J. Super. Ct. App. Div. 2006), the court relied upon *Weedo* and concluded that a bottling company's faulty work in the preparation of carbonated beverages contaminated with ammonia did not fall within the coverage provided to the bottling company. *Hillside*, 903 A.2d at 518-20. Hillside Bottling Company ("Hillside") produced and bottled soft drinks for various customers. *Id.* at 515. Hillside's customers provided Hillside with flavorings and sugar, and Hillside itself provided other ingredients such as carbon dioxide. *Id.* During the bottling process, Hillside used an ammonia gas-refrigerated device, which cooled the beverages and added carbon dioxide to them to create carbonation. *Id.* One of Hillside's customers discovered that its soft drink product was contaminated with ammonia and three customers eventually recalled all beverage products produced at the Hillside facility. *Id.*

The customers demanded that Hillside indemnify them for all costs related to the recall, and one of the customers filed suit against Hillside. *Id.* Hillside in turn tendered the claims to Atlantic Mutual Insurance Company ("Atlantic Mutual"), which responded that its coverage obligation was limited to the amount provided in a product recall endorsement. *Id.* at 516. Atlantic Mutual paid the amount afforded under the endorsement, and then brought a declaratory action seeking a determination that it was not obligated to defend Hillside, or to cover any of Hillside's costs or losses, in excess of the endorsed amount. *Id.* Although the trial court concluded that the Atlantic Mutual policy did cover the claims asserted against Hillside, and that Atlantic Mutual was required to defend them, the appellate court disagreed, relying upon the reasoning in *Weedo*. *Id.* at 518-20. In concluding that the *Weedo* doctrine barred coverage under the policy, the appellate court reasoned that Hillside was responsible for mixing the carbon dioxide into beverages and it was during this step that the beverages became contaminated with ammonia. *Id.* at 519-20. Thus, the court concluded that Hillside's work mixing the beverages was defective, and that because Hillside was seeking coverage for its own faulty work, the claims were not covered under the policy. *Id.* at 520.

Unlike the *Hillside* court, the court in *Naumes, Inc. v. Chubb Custom Ins. Co.*, No. 05-1327-HA, 2007 U.S. Dist. LEXIS 1292 (D. Or. Jan. 5, 2007), concluded that an insured's "erroneous introduction of a premix containing substances banned in the market for which the product was intended" was an occurrence that led to the destruction, and loss of use, of tangible property. *Naumes*, 2007 U.S. Dist. LEXIS 1292 at \*13-14. *Naumes, Inc.* ("Naumes") provided concentrated diet drink mixes to a customer that required the concentrate to conform to Japanese food and drug regulations. *Id.* at \*3. The Japanese regulations required that the drinks contain neither biotin nor Vitamin E, and when Japanese authorities compelled a recall of the drinks because they contained both, the insured's customers sued the insured for delivering a non-conforming product. *Id.* at \*3-4.

*Naumes* tendered the defense of its customer's claims to Chubb Custom Insurance Company ("Chubb"), which disclaimed any obligation to defend *Naumes*. *Id.* at \*1. The court reasoned that the mistaken introduction of the biotin- and Vitamin E-containing mix was an unexpected consequence that led directly to the loss of the customer's product. *Id.* at \*12-14. Thus, there was an "occurrence" as defined in the policy, and the court concluded that Chubb was required to defend *Naumes*. *Id.*

Similarly, in *Zurich American Ins. Co. v. Cutrale Citrus Juices USA, Inc.*, *supra*, the court held that adulteration of an insured's juice product constitutes an "occurrence" when the claimant uses the adulterated product in the claimant's own juice products. *Cutrale*, 2002 WL 1433728 at \*3, *supra*; *see also Terra Indus., Inc.*, 216 F. Supp. 2d. at 918-19, *supra* (same).

## 2. Number of Occurrences

Liability policies generally restrict the amount of coverage available under the policy by means of a per occurrence limit (the most the insurer will pay for a single accident) and an aggregate limit (the most the insurer will pay for all accidents covered under the policy during a specific policy period.).

The determination of the number of occurrences in any given claim can have substantial monetary ramifications. Using the recent E. coli outbreak, which stemmed from fresh bagged salad as an example, the number of occurrences will eventually be a critical issue as claims are adjusted over the next several years. We assume, for the sake of this example, the grower has a single commercial general liability policy issued to it for the 2007 policy period with limits of \$1 million per occurrence and \$5 million aggregate. If a court determines that the "occurrence" was the cultivation process of the insured's contaminated product, the coverage available to the insured may be limited to the single limit of \$1 million. If a court determines that the occurrence is the exposure of the consumers to the E. coli-contaminated spinach, then each injured claimant may trigger a separate occurrence and, as a result, the coverage available to the insured would be a maximum of \$5 million – the aggregate limit. In this example, the

difference between a single occurrence finding and a multiple occurrence finding is a hefty \$4 million (the difference between the \$5 million aggregate limit and the single \$1 million per occurrence limit).

The vast majority of judicial authority determines the number of occurrences in a liability policy by examining the *cause* of the loss rather than the *effect*. Although this sounds simple enough, determining the precise cause of an insured loss is often a complicated analysis driven by the desired result – i.e., in many cases, the court’s desired result may be to maximize coverage. Since a finding of multiple occurrences often results in more coverage being available to the insured for its liability, it is not unusual to see a court analyze the facts of any given claim in such a way as to find more than one occurrence. For instance, where multiple customers of a restaurant were infected with botulism from contaminated onions, the court found that the liability-causing conduct was the serving of the onions to the customers, not the preparation of the onions prior to serving. As such, the serving of the customers to each individual customer constituted a separate occurrence. *Mason v. The Home Ins. Co. of Ill.*, 532 N.E.2d 526 (Ill. App. Ct. 1988); *see also Michigan Chem. Corp. v. American Home Assurance Co.*, 728 F.2d 374 (6th Cir. 1984) (Where the insured mistakenly shipped toxin-containing flame retardant to its customers, instead of a livestock feed supplement, resulting in the destruction of over 40,000 animals, the court held that each shipment of the flame retardant, not the number of claimants, constituted a separate occurrence).

Recently, the issue before the court in *International Flavors & Fragrances, Inc. v. Royal Ins. Co. of America*, 844 N.Y.S.2d 257 (NY App. Div. 2007), was whether under New York’s unfortunate-event standard thirty separate personal injury claims constituted one “occurrence” or whether each claim constituted a separate “occurrence.” International Flavors manufactured butter flavoring used in microwave popcorn and sold the flavoring to a microwave popcorn packaging company. The claimants worked for the packaging company and asserted that the butter flavoring contained diacetyl and other volatile organic compounds, which upon their exposure to same, caused lung impairment and other respiratory injuries. International Flavors brought a declaratory judgment action against several of its insurers, seeking a determination of coverage with respect to a class action lawsuit filed by the injured claimants. At issue was whether International Flavors would be required to satisfy the policies’ self-insured retentions in the amount of \$50,000 or \$100,000, and applicable on a per occurrence basis, for one occurrence or for thirty separate occurrences. The insurers argued that each claim constituted a separate occurrence, but International Flavors argued that: “. . . Exposure of the injured employees to the hazardous ingredients in [the] butter flavoring constitutes a single occurrence, without regard to the number of employees who were injured.” International Flavors argued that its repeated and continuous sale of butter flavoring over a number of years should be considered one occurrence. The court rejected International Flavors’ argument, concluding that the sale and “shipment of butter flavoring . . . presented only the potential for injury; it was the exposure to diacetyl and other volatile compounds, though

gradual and continuing over the course of years, that precipitated the actual harm, comprising the occasion giving rise to liability . . . .” In reaching its conclusion, the court reasoned that: “Occurrence is not defined by the injury sustained but rather in terms of its cause.” Because thirty different people were continuously exposed to diacetyl on different occasions and extending over different time periods, the court held that there were thirty separate occurrences.

In contrast to *Mason and International Flavors*, in *Fireman’s Fund Ins. Co. v. Scottsdale Ins. Co.*, 968 F.Supp. 444 (E.D. Ark. 1997), the insured operator of a Taco Bell franchise was sued after several of its customers were infected with the Hepatitis A virus after eating contaminated meat. The court was asked to determine whether the alleged acts of food poisoning constituted a single occurrence or whether each separate case of food poisoning constituted a separate occurrence. Scottsdale, the primary insurer, argued that the accident causing the resulting injuries was the improper preparation and/or storage, handling, etc. of the food, and that this should have been regarded as having “occurred” once. Therefore, Scottsdale argued, it was irrelevant how many customers became ill upon consuming the food. A finding of a single occurrence would have limited Scottsdale’s exposure to a single per occurrence limit of \$1 million. The excess insurer, Fireman’s Fund, argued that each sale of the contaminated meat was a separate occurrence and that the improper handling, preparation, or storage of food, by itself, was not injurious to anyone and thereby did not subject the insured to potential liability until the meat was actually served to the public. According to Fireman’s Fund’s argument, it was the *sale* of the meat which potentially triggered the insured’s liability and, therefore, every sale resulting in injury constituted a separate occurrence. A finding of multiple occurrences would have increased the exposure of the primary insurer from \$1 million to \$2 million, thereby decreasing the excess insurer’s exposure by \$1 million. Without much discussion, the *Fireman’s Fund* court held that multiple sales of contaminated meat at one restaurant was the result of a single occurrence.

#### **D. Pollution Exclusion**

Once an insured has established the applicability of a liability policy’s “bodily injury” or “property damage” coverage, the coverage inquiry does not end. There are multiple policy exclusions in a liability policy that may have an impact on the ultimate coverage determination.

For example, many liability policies contain pollution exclusions that generally preclude coverage for “bodily injury” or “property damage” arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of “pollutants.” “Pollutants” are generally defined to include “any solid, liquid, gaseous or thermal irritant or contaminant, including . . . waste.” There are various types of food contaminants and various sources for such contamination. Whether or not the pollution exclusion is applicable in any given coverage evaluation will depend upon the specific facts underlying the claim. One of the

more notorious sources of contamination that has received significant publicity in the last decade is E. coli bacteria. In the recent spinach outbreak emanating from crops in California's Central Valley, the E. coli contamination was caused by the release of animal waste during the growth and irrigation process. In many cases, animal waste may meet a liability policy's definition of "pollutant." Furthermore, E. coli bacteria itself may constitute a "pollutant." With respect to the discharge, dispersal or release, etc. element of the pollution exclusion, the discharge may be the irrigation of the contaminated produce with contaminated water or the spreading of fertilizer.

Courts in general are divided on the applicability of the pollution exclusion outside of industrial pollution context. There are few cases addressing the pollution exclusion in the food contamination setting. However, it should be noted that at least one state court has rejected the application of the pollution exclusion in the food contamination setting. See *Keggi v. Northbrook Prop. & Cas. Ins. Co.*, 13 P.3d 785 (Ariz. Ct. App. 2000 ). In *Keggi*, the claimant brought suit against the insurer after she drank water contaminated with fecal coliform bacteria and became very ill. The trial court had granted summary judgment in favor of the insurer on the basis of the pollution exclusion. The appellate court reversed the trial court's ruling, however, and held that the pollution exclusion was inapplicable. The liability policy at issue in *Keggi* included fairly standard pollution exclusion language which defined the term "pollutant" as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."

With respect to whether the fecal coliform bacteria constituted an "irritant" or "contaminant," the *Keggi* court noted that the policy limited its exclusion to "irritants" or "contaminants" that are "solid, liquid, gaseous or thermal." The court further opined that ["(t)o the extent that [the fecal coliform] bacteria might be considered 'irritants' or 'contaminants', they are *living, organic* irritants or contaminants which defy description under the policy as 'solid,' 'liquid,' 'gaseous,' or 'thermal' pollutants." *Id.* at 789 (emphasis in original). In addition, the court noted that the pollution exclusion delineated the types of contaminants or irritants included within the definition of "pollutants" to include "smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." These enumerated items, according to the *Keggi* court, are primarily *inorganic* in nature and, therefore, the fecal coliform bacteria, as a *living organism*, is not similar to the exclusion's enumerated list. *Id.* at 790. Based on this reasoning, the court concluded that the "plain language of the pollution exclusion does not include . . . fecal coliform bacteria within the definition of 'pollutants.'" *Id.* Thus, the pollution exclusion did not apply to preclude coverage for the claimant's injuries.

The applicability of the pollution exclusion will vary from case to case. The first issue that should be examined is whether the food contamination at issue involves a "pollutant" (as that term is defined in the policy) that has been discharged or released as required by the pollution exclusion. If that requirement has been met,

the applicability of the pollution exclusion will likely depend upon what jurisdiction(s) is involved. In those states that have narrowly construed pollution exclusions and limited their applicability to “traditional” environmental pollution claims, it is likely that the pollution exclusion will not apply. *American States Ins. Co. v. Koloms*, 687 N.E.2d 72 (Ill. 1997) (court found that accidental release of carbon monoxide due to the fact that subject furnace was broken did not constitute the type of environmental pollution contemplated by the absolute pollution exclusion in a liability policy).

In contrast, a number of jurisdictions look to the “plain meaning” of the pollution exclusion and bar coverage for pollution claims regardless of whether the claim involves traditional environmental damages. *Technical Coating v. U.S. Fid. & Guar. Co.*, 157 F.3d 843 (11th Cir. 1998) (applying Florida law) (absolute pollution exclusion unambiguously excluded coverage for bodily injuries sustained by breathing vapors emitted from insured’s roofing products); *Certain Underwriters at Lloyd’s v. C.A. Turner Const.*, 112 F.3d 184 (5th Cir. 1994) (applying Texas law) (pollution exclusion did not limit its application to only those discharges causing environmental harm; in contrast, it speaks broadly of “liability for any bodily or personal injury.” “This language is not ambiguous; a plain reading of the clause dictates the conclusion that all damage caused by pollution, contamination, or seepage is excluded from coverage.”); *The Cincinnati Ins. Co. v. Becker Warehouse, Inc.*, 635 N.W.2d 112 (Neb. 2001) (where claimants’ food products were contaminated by xylene fumes from a concrete floor sealant, court applied the pollution exclusion to preclude coverage and rejected insured’s argument that pollution exclusion only applies to “traditional environmental pollution claims”).

#### **E. Work/Product Exclusions**

Most standard CGL policies exclude coverage for property damage to the insured’s work as well as property damage to the insured’s product. Commercial liability policies are not designed to provide insureds with coverage against claims their work is inferior or defective. The risk of replacing and repairing defective products has generally been considered a *commercial* or *business risk* that is not passed on to the liability insurer. Rather, liability coverage comes into play when the insured’s defective product or work causes injury to property other than the insured’s own work or products (i.e., third-party property damage).

In light of the nature of food contamination claims, the work/product exclusions are frequently at issue. The applicability of the work/product exclusions is extremely fact sensitive. Practically speaking, costs that are associated merely with the repair or replacement of the insured’s defective work or product are not covered by a liability policy.

In the food distribution process, there are many individual links to the chain of distribution. Claims against insured entities that supply one ingredient to a larger

contaminated product are not excluded from coverage by the product exclusion as the contaminated product (the larger product into which the supplier's smaller product was incorporated) is not the insured supplier's product. *Olympic Steamship Co. v. Centennial Ins. Co.*, 811 P.2d 673 (Wash. 1991) (product exclusion inapplicable where the insured warehouse simply affixed packer-supplied labels to cans of salmon and boxed the cans using its own casing equipment – court held that exclusion was inapplicable since the insured simply provided a service and was not the “manufacturer” of the product).

On the other hand, the costs associated with repairing or replacing a product manufactured or grown by the insured are excluded from coverage. *Nu-Pak, Inc. v. Wine Specialties Int'l Ltd.*, 642 N.W.2d 848 (Wis. Ct. App. 2002 ); *see also Tradin Organics USA, Inc. v. Maryland Cas. Co.*, 2008 WL 241081 (S.D.N.Y. Jan. 29, 2008); *Hartog Rahal P'ship v. American Motorists Ins. Co.*, 359 F. Supp. 2d 331 (S.D.N.Y. 2005) (juice concentrate adulterated with a safe, but artificial, sweetener constituted the insured's product, and was, therefore, excluded from coverage through application of the “your product” exclusion). In the *Nu-Pak* case, the claimant, Wine Specialties, had developed a freezable alcoholic beverage to be packaged and sold to consumers. Under the terms of a written contract, the insured entity, Nu-Pak, agreed to mix and package the product with ingredients provided by Wine Specialties. Nu-Pak sued Wine Specialties in response to a billing dispute. Wine Specialties brought a cross-complaint against Nu-Pak alleging that quality control problems at Nu-Pak lead to the improper formulation of the product which made it unfit for human consumption. Wine Specialties also brought a third party complaint against Nu-Pak's general liability insurer, alleging its claim against Nu-Pak was covered under Nu-Pak's CGL policy. The appellate court in *Nu-Pak* applied the “your product” exclusion and held that there was no coverage for the claim for damage to the goods and/or products manufactured by Nu-Pak. In addition, the court held that the product exclusion excluded coverage for the cost of removing the contaminated product, the value of lost future sales and profits, and the damage to the reputation of Wine Specialties. These damages, according to the court, were incidental to excluded property damage and did not constitute damage to *other* property.

Another interesting case examining the applicability of the product exclusion is the Wisconsin Court of Appeal's opinion in *Holsum Foods Division v. Home Ins. Co.*, 469 N.W.2d 918 (Wis. Ct. App. 1991). In *Holsum*, the policy barred coverage for “property damage to the named insured's products arising out of such products or any part of such products.” Holsum had manufactured and packaged barbeque sauce. The ingredients, jar, label and cap were supplied by the licensor. However, Holsum mixed the ingredients, added a sweetener it supplied, cooked the mix, and put it into jars, which were then packed into cases and stored until shipment. During the bottling process, a filler tube struck the inside of the jars, breaking glass chips into the jars; eventually, glass chips were discovered in two to three percent of the jars. The entire lot of barbeque sauce was destroyed because there was no way to determine which jars contained glass

chips. The coverage issue in *Holsum* turned on whether the barbeque sauce was Holsum's product or whether Holsum had provided a service that damaged the product owned by the licensor. Because Holsum provided one ingredient and cooked and mixed all the ingredients together, the court found that the barbeque sauce was Holsum's product. As such, the product exclusion precluded coverage.

And in *Lowville Producer's Dairy Coop., Inc. v. Am. Motorists Ins. Co.*, 604 N.Y.S.2d 421 (N.Y. App. Div. 1993), a dead mouse was found in the hose leading from a milk truck to a storage silo. The court found that the cost of milk itself (the insured's product) was excluded from coverage on the basis of the product exclusion, but the cost of cleaning the silo was covered because the silo was the property of an injured third party, in that the silo was rendered unclean from the contaminated product. Similarly, in *L.D. Schreiber Cheese Co. v. Standard Milk Co., Inc.*, 457 F.2d 962 (8th Cir. 1972), the court also applied a narrow interpretation of the "your product" exclusion. *Schreiber Cheese*, 457 F.2d at 966-68. There, the claimant sought recovery of expenses it had incurred in testing 4 million pounds of cheese for enterotoxin, a poisonous bacterial by-product. *Id.* at 963. Only about three percent of the cheese was actually contaminated and the claimant sold the remainder. *Id.* at 967. The court held that the "your product" exclusion precluded coverage for the contaminated cheese, but not for the good cheese. *Id.* at 967-68. Reasoning that the entire amount of cheese should not be considered one product, the court concluded that the policy provided coverage for the claimant's costs incurred in testing the good cheese. *Id.*

The critical question is this: Is the damaged property the insured's product? If the answer is yes, the work/product exclusions apply to preclude coverage. If the answer is no, it is likely that the work/product exclusions are inapplicable.

## **F. Impaired Property Exclusion**

Impaired property is typically defined in liability policies as tangible property, other than the insured's work or product, that cannot be used or is less useful because it incorporates the insured's work or product that is known or thought to be defective or deficient, if such property can be restored to use by the repair, replacement or removal of the insured's product. The impaired property exclusion reflects the principle that the risk of replacing or repairing a defective product is considered a commercial risk that is not passed on to a liability insurer. *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 78 Cal. App. 4th 847 (Cal. Ct. App. 2000). The majority of courts strictly construe the impaired property exclusion, requiring that an insurer show that every element of the exclusion is satisfied before a court will apply the exclusion to preclude coverage for a claim. For instance, where the insured's product can be salvaged, but not restored to use by the repair or replacement of a defective component, the impaired property exclusion does not apply. *Id.* at 867; *see also Naumes*, 2007 U.S. Dist. LEXIS 1292 at \*14-15, *supra* (the impaired property exclusion is inapplicable when there was no evidence that the claimant's product could be

restored to use by the repair or replacement of the insured's defective product or work). Additionally, the impaired property exclusion will not apply to exclude coverage if the "impaired product" is physically injured. *See Mullins' Whey, Inc. v. McShares, Inc.*, No. 04-C-0130, 2005 WL 1154281 at \*3 (E.D. Wis. 2005) (coverage for damages to the claimant's food product, which was ruined as the result of using the insured's benzene-contaminated whey protein, was not excluded through application of the impaired property exclusion); *Cutrale*, 2002 WL 1433728 at \*5, *supra* (same).

As with the other business risk exclusions, such as the work and product exclusions discussed above, the impaired property exclusion may have application to food contamination claims, but that application would only be in instances in which there was no physical injury to a third party's tangible property. Instead, a defective condition of the insured's product must have caused a loss of use of the property of a third party, but that property must still be restorable to use by the removal of the insured's work or product.

### **G. Sistership Exclusion**

The product recall exclusion typically included in general liability policies is commonly referred to as the "sistership" exclusion. The "sistership" exclusion derives its name from an occurrence in the aircraft industry where all airplanes of a certain make and type were grounded by an order of the Civil Aeronautics Administration because of a defect and others were suspected of having a common structural defect. The damages arising out of the grounding of all "sister ships" were enormous.

Although there are various versions of the sistership exclusion in liability policies, the exclusion generally excludes coverage for property damage claims for the withdrawal, repair or replacement of the insured's work or product if such product or work is withdrawn from the market or from use because of a suspected defect or deficiency in the product.

The focus of most coverage litigation addressing the sistership exclusion is on the withdrawal element of the exclusion. A frequently contested issue is whether the sistership exclusion applies to the withdrawal and recall of defective products by the named insured only or whether the exclusion extends to the claimant's recall of the insured's work or product. The majority of courts hold that the sistership exclusion applies exclusively to claims involving recalls by the named insured. *U.S. Fire Ins. Co. v. Good Humor Corp.*, 496 N.W.2d 730, 738 (Wis. Ct. App. 1993) (sistership exclusion did not apply when the manufacturer of ice cream contaminated with *Listeria monocytogenes* was sued by retailer of the contaminated ice cream where the retailer, not the manufacturer, had recalled the product); *Thomas J. Lipton, Inc. v. Liberty Mutual Ins. Co.*, 357 N.Y.2d 705; 314 N.E.2d 37 (1974); *Elco Indus. Inc. v. Liberty Mut. Ins. Co.*, 414 N.E.2d 41 (Ill. App. Ct. 1980); *Olympic Steamship Co. v. Centennial Ins. Co.*, 811 P.2d 673

(Wash. 1991) (en banc) (sistership exclusion does not apply where third party withdraws the insured's product from the market); *cf. Mullins' Whey, Inc.*, 2005 WL 1154281 at \*3, *supra* (sistership exclusion inapplicable when the claimant seeks recovery of damages for the recall of its own product, but not for the recall of the insured's product); *but see Hillside*, 903 A.2d at 521-23, *supra* (sistership exclusion applies to bar coverage where insured bottling company's customers recalled ammonia contaminated soft drinks); *Hamilton Die Cast, Inc. v. U.S. Fid. & Guar. Co.*, 508 F.2d 417, 420 (7th Cir. 1975) (court did not recognize third party exception to sistership exclusion).

In the *Thomas J. Lipton* case, *supra*, New York's highest court affirmed coverage for a manufacturer that had sold contaminated noodles to a soup-mix manufacturer for use in its dry-soup mixes. After discovering that some of the noodles were contaminated, the soup-mix manufacturer recalled and destroyed its inventory of finished soup mixes and sued the noodle manufacturer for reimbursement and other damages. The court held that the sistership exclusion did not clearly and unambiguously apply to bar coverage for damages as it was the soup-mix manufacturer, not the noodle maker, that issued the recall. *Id.* The court further stated that had the insured noodle maker conducted the recall, the sistership exclusion would have precluded coverage. *Id.* at 707-08.

Another area of dispute in the application of the sistership exclusion is the scope of the recall meant to be addressed by the exclusion. A majority of courts interpreting the sistership exclusion have held that the exclusion applies exclusively to market-wide recalls. Moreover, these courts have held that the repair and replacement of products that have actually failed in use, with no attempt to prevent future failures by the removal of other similar products, does not constitute a withdrawal under the exclusion. In other words, the sistership exclusion only applies to market-wide recalls, not to the partial withdrawal of individual or partial groups of defective products. *Travelers Ind. Co. v. Dammann & Co., Inc.*, 2008 WL 370914 (D.N.J. Feb. 11, 2008); *Forest City Dillon Inc. v. Aetna Cas. & Sur. Co.*, 852 F.2d 168 (6th Cir. 1988); *Fitness Equip. Co. v. Pennsylvania Gen. Ins. Co.*, 493 So.2d 1337 (Ala. 1986); *Imperial Cas. & Indem. Co. v. High Concrete Structures, Inc.*, 858 F.2d 128 (3d Cir. 1988).

One final limitation on the application of the sistership exclusion is the principal that it is directed toward excluding the costs of preventive measures and does not bar coverage for damages for actual injury or damage caused by the defect in the product. *Atlantic Mut. Ins. Co. v. Judd Co.*, 380 N.W.2d 122, 125 (Minn. 1986) (repair and replacement of products that actually failed in use, with no attempt to prevent future failures of other similarly suspect products, does not constitute withdrawal); *Gulf Ins. Co. v. Parker Products, Inc.*, 498 S.W.2d 676 (Tex. 1973) (sistership exclusion did not apply to preclude coverage where the claimant did not allege a mere withdrawal, but instead alleged the loss of use of contaminated ice cream ingredients which were destroyed because of food flavoring that had been contaminated).

### **III. First Party Coverage**

#### **A. All Risk Versus Named Peril Policies**

First-party policies typically cover either specific causes of loss (“named peril” policies) or all risks of physical loss (“all risk” policies) that result in physical property damage.

All-risk policies usually extend to risks not usually covered under other insurance. Recovery under an all-risk policy will, as a rule, be allowed for all fortuitous losses not resulting from misconduct or fraud, unless the policy contains a specific provision expressly excluding the loss from coverage.

In contrast, named-peril policies restrict coverage to claims stemming from certain enumerated risks.

Thus, the coverage provided by an all-risk policy is much broader than that provided by a named-peril policy.

#### **B. Physical Damage Requirement**

Both all-risk and named peril policies limit coverage to risks that result in physical property damage. In the contamination setting, the majority of courts have held that the contamination of food products meets the requirement for physical damage. *Blaine Richards & Co. v. Marine Indem. Ins. Co.*, 635 F.2d 1051 (2d Cir. 1980) (fumigation of beans with pesticide not approved for use in the United States resulted in physical damage covered by the policy).

The majority of jurisdictions in the United States have held that a product suffers “physical injury” where it is in violation of FDA regulations. Where a food product is contaminated and unfit for human consumption, many courts find the “physical injury” requirement is met. However, the “physical injury” analysis is murkier where a food product is only in *technical* violation of FDA regulations, but is still fit for human consumption and does not pose any risk of physical harm to the consuming public. Insurers have questioned whether a product has been physically injured where the consumption of the product does not pose a health threat. In response to this question, several courts have held that the “physical injury” requirement is met where the food product is only in technical violation of FDA regulations but is still fit for human consumption. *General Mills Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147, 152 (Minn. 2001) (insured’s oat product was treated with a pesticide which was in violation of FDA regulation; even though the oat product was fit for human consumption and did not pose a threat to public safety, court held that oat product was physically damaged since it was in violation of FDA regulations); *Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co.*, 98 N.W.2d 280 (Minn. 1959).

Recognizing that the majority of courts to address the issue have found contaminated foods meet the physical damage requirement, the next logical question is whether there is coverage for food products that were not necessarily contaminated, but were destroyed as part of a product recall. In *S. Wallace Edwards & Sons, Inc. v. Cincinnati Ins. Co.*, 353 F.3d 367 (4th Cir. 2003), the insurer argued that the physical damage requirement in its policy was not met where the insured had not tested each item after a contamination outbreak, but instead had destroyed all of its product that was potentially exposed, despite the fact that most of its product that was tested did not show harmful concentrations of ammonia. In reviewing the insurer's coverage position, the *Wallace* court rejected the insurer's argument that the insured had failed to prove that its ham products had been physically damaged from accidental exposure to anhydrous ammonia gas. The court held that "even if the insured destroyed too much of the ham rather than examining it piece by piece to see which was discolored and which smelled of ammonia . . . no duty of minimizing damages would require (the insured) to so segregate the thousands of pieces of ham involved where there was a very real chance of risk to human health in selling the product for human consumption." *Id.* at 375.

Another relevant issue is whether the physical damage requirement is met where the insured's food product has been exposed to a chemical agent that is not approved for human consumption or is not approved for the particular food, but does not actually pose a human health threat. Under these circumstances, certain courts have found that the physical damage requirement has been met even where the product poses no human health threat. *Blaine Richards & Co. v. Marine Indem. Ins. Co.*, 635 F.2d 1051 (2d Cir. 1980); *General Mills v. Gold Medal Ins. Co.*, 622 N.W.2d 147 (Minn. Ct. App. 2001).

In contrast, where recalls impact products that are not contaminated, the physical damage or physical loss requirement in first-party policies has not been met and, therefore, there is no coverage for related economic losses. For instance, the recent outbreak of mad cow disease in Canada in 2003 caused U.S. officials to close the border to beef product imports. The insured manufacturer of beef products suffered business interruption expenses and lost profits because its product was located on the Canadian side of the border when it was closed. The court found that the insured was not entitled to coverage for its lost business income as its beef products, which were *not* infected with mad cow disease, did not satisfy the policy's physical damage requirement. *See Source Food Tech., Inc. v. United States Fid. & Guar. Co.*, 465 F.3d 834 (8th Cir. 2006).

### **C. Damages Covered Under First Party Policy**

First-party policies are not uniformly drafted. As such, the scope and type of damages covered under a first-party policy will depend upon the precise language of the policy. However, it should be noted that the following types of damages

which, as one could imagine, may be astronomical in a large-scale contamination outbreak, may be covered under a first-party policy issued to an insured in the food distribution chain.

1. Business Interruption Costs;
2. Replacement Costs/Product Refunds;
3. Lost Profits;
4. Costs Associated with Recall of Product (expenses for issuing warnings, checking the recalled product, etc.);
5. Costs to Destroy Contaminated Product; and
6. Expenses to Rehabilitate the Product's Brand Reputation.

Typically, these policies indemnify the insured for the actual cash value of the damaged materials, usually determined flexibly under what is known as the broad-evidence rule, which permits consideration of market price, replacement cost and other factors. *See Interstate Gourmet Coffee Roasters, Inc. v. Seaco Ins. Co.*, 794 N.E.2d 607 (Mass. App. Ct. 2003) (where employee's fingers were caught in a coffee-roasting plant's grinding machine, necessitating the destruction of the contaminated coffee and extensive clean up and sanitization measures, actual cash value was determined by intended selling price less unincurred packaging and delivery costs and not by cost of goods plus processing expense).

First-party property policies also may provide for mandatory or optional appraisal proceedings, where relevant experts in an arbitration-like setting determine the value of the loss (but not coverage questions such as the applicability of an exclusion). *See Merrimack Mut. Fire Ins. Co. v. Batts*, 59 S.W.3d 142 (Tenn. Ct. App. 2001). Where there is covered physical damage, first-party policies often separately provide coverage also for business interruption or lost-profits coverage stemming from a physical inability to continue to operate and for the cost of extra expenses to return the business to operation. Extra-expense coverage will reimburse the insured (subject to the policy's terms) for a variety of additional costs the insured incurs in setting up alternative facilities and the like. *See Am. Med. Imaging Corp. v. St. Paul Fire & Marine Ins. Co.*, 949 F.2d 690, 693 (3d Cir. 1991) (increased payroll for overtime, additional utility expense, alternative office space); *Charles Dowd Box Co. v. Fireman's Fund Ins. Co.*, 218 N.E.2d 64, 71 (Mass. 1996) (overtime, utility, and telephone costs); *Travelers Indem. Co. v. Pillar Friendly Ford Co.*, 512 S.W.2d 375, 377 (Tex. Ct. App. 1974) (overtime, rent for alternative office space, temporary property, cleanup expenses); *A. Miller & Co. v. Cincinnati Ins. Co.*, 577 N.E.2d 885, 887 (Ill. 1991) (overtime, additional storage and transportation costs, replacement of inventory and raw materials used to reduce the overall loss); *Northwestern States Portland Cement Co. v. Hartford Fire Ins. Co.*, 360 F.2d 531, 533 (8th Cir. 1966) (replacement of inventory and raw materials to reduce the loss).

#### D. Contamination Exclusion

The applicability of exclusions to any given claim depends upon an application of the facts underlying the claim to the specific terms of the policy at issue. In the context of food contamination claims, the contamination exclusion is one of the most litigated exclusions in the first-party policy context.

The majority of courts to address the contamination exclusion have enforced the exclusion unless the facts supported the application of an exception to the contamination exclusion. For example, many contamination exclusions contain an exception for property damage resulting from an explosion. In other words, the policy will exclude coverage for property damage stemming from contamination except where the contamination results from an explosion. *American Produce & Vegetable Co. v. Phoenix Assurance Co. of New York*, 408 S.W.2d 954 (Tex. 1996) (contamination exclusion precluded coverage for claim where the insured's product was contaminated by the leakage of ammonia from refrigeration units); *accord American Casualty Co. of Reading, Pennsylvania v. Myrick*, 304 F.2d 179 (5th Cir. 1962). Some courts will also look to whether the contamination at issue resulted from an *actual* contamination versus a *suspected* contamination. *See Richland Valley Products, Inc. v. St. Paul Fire & Cas. Co.*, 548 N.W.2d 127 (Wis. Ct. App. 1996), *review denied*, 204 Wis. 2d 318, 555 N.W.2d 123 (1996) (although refrigeration system malfunctioned soon after mixing occurred, contamination within meaning of policy exclusion could be quick and did not need to be slow process).

At least one court has held that products voluntarily destroyed after a *suspected* contamination, where the investigation later determined that there was no *actual* contamination, are not excluded from coverage by a contamination exclusion. *Stanley Duennsing v. The Travelers Companies*, 849 P.2d 203 (Mont. 1993).

In contrast to what appears to be the majority position, certain courts have refused to enforce the contamination exclusion where the risk of third-party negligence was not expressly excluded (unlike vice, latent defect, and other risks). It should be noted that in these cases where the contamination exclusion was not applied, the relevant exclusions contained an exception for risks of loss not enumerated in the exclusion – i.e., the contamination exclusion contained a “buy back” exception which provided coverage for risks of loss not specifically set forth in the exclusion. *General Mills, Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147 (Minn. Ct. App. 2001).

In *Allianz Ins. Co. v. RJR Nabisco Holdings Corp.*, 96 F. Supp. 2d 253 (S.D.N.Y. 2000), Nabisco began receiving numerous telephone calls on its toll-free customer service line “concerning a chemical odor and flavor in various Nabisco products.” After investigation, Nabisco determined that all the affected products had been stored in the AUL warehouse, and that they all contained trimethyl

benzene (“TMB”), a chemical that, while posing no health risk, “would cause a strong displeasing odor and taste in food products.” Further investigation revealed that the construction company that had built the AUL warehouse had stripped and sealed the concrete floor with chemicals containing TMB, which, according to Nabisco, the company had failed to seal and clean up properly, thus leading to the contamination of the subsequently-stored foodstuffs. Based on its investigation, Nabisco recovered and destroyed over one million cases of food that had been stored at the AUL warehouse. Nabisco then submitted a claim to Allianz and its co-insurers. In turn, Allianz sought a declaration that coverage of the loss was barred by contamination exclusion. The court ruled against Allianz, holding that contamination exclusion did not apply to contamination of food products exposed to TMB from the warehouse where they had been stored, which, though posing no health risk, resulted in a displeasing odor and taste.

In *The Pillsbury Co. v. Zurich American Ins. Co.*, No. 03-6560, 2005 WL 2778752 (D. Minn. Oct. 25, 2005), the court ruled that the contamination exclusion does not exclude coverage for losses associated with biscuit mix containing pieces of plastic, concluding that the definition of “contaminate” implies that impurities are particulate or chemical in nature and that plastic screen pieces don't constitute “contamination”).

In an all-risk policy, as discussed briefly above, the policy covers all risks unless specifically excluded by the policy. Where the food contamination at issue was the result of more than one cause, one of which is excluded from coverage and one of which is not, the majority of courts will find coverage where the covered cause of loss is the primary cause of the contamination loss. *Bruce Oakley, Inc. v. Farmland Mut. Ins. Co.*, 245 F.3d 1027 (8th Cir. 2001) (court held that damage to soybeans stored in a bin that auto-oxidized from a mold were damaged by heat, a covered risk, generated from the fungus or, in the alternative, fell within an ensuing fire exception to a mold exclusion); *see also Craig B. Cooper, Olive Indus. Ltd. v. Travelers Indem. Co. of Illinois, et al.*, 2004 U.S. App. LEXIS 21324 at \* 4 (9th Cir. 2004) (where contamination emanated from a sewer backup and resulting leak from the municipal manhole in the street in front of the property, and court ruled that there was no coverage for any spoilage of food pursuant to a food contamination provision in the policy requiring contamination to occur from the purchase of tainted food or transmission of a communicable disease from an employee).

#### **E. Pollution Exclusion**

Similar to third-party liability policies, some first-party policies also include pollution exclusions. Like the analysis of the pollution context in the third-party context, the courts are split on the interpretation of the pollution exclusion with respect to first-party policies as well.

Some courts have looked to the plain language of the pollution exclusion to find that a contaminated food product is a “contaminant” for the purposes of a pollution exclusion. A typical first-party policy pollution exclusion may exclude coverage for pollutants where pollutants are defined as, “any solid, liquid, gaseous, or thermal irritant or contaminant . . . .” See *Landshire Fast Foods v. Employers Mut. Cas. Co.*, 676 N.W.2d 528 (Wis. Ct. App. 2004).

In *Landshire*, Landshire prepared sandwiches and other foods for sale to businesses and institutions. In 1999, Landshire began delivering sandwiches to the Great Lakes Naval Training Station (“Great Lakes”) commissary. On May 31, 2000, Great Lakes reported it had discovered the *Listeria monocytogenes* (“Listeria”) bacteria in some of Landshire’s products. This form of Listeria can cause mild flu-like symptoms in healthy adults; however, in more vulnerable populations such as the elderly, this bacteria can cause a life-threatening illness with a twenty-five percent mortality rate. Great Lakes returned all of the food to Landshire and refused to accept any additional Landshire products.

Employers Mutual Casualty Company had issued a policy to Landshire that was in effect at the time of the Listeria outbreak. The policy contained a pollution exclusion where the term “pollutants” was defined as “any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.” The parties to the coverage litigation disagreed on the scope of the term “contaminant” in the pollution exclusion. While Landshire conceded that Listeria is a contaminant, it denied that Listeria is the kind of contaminant the Employers’ policy excluded from coverage. Asserting that the Employers’ policy language only excluded *inorganic* matter, Landshire argued that the pollution exclusion was inapplicable to the Listeria outbreak as Listeria does not fall within the “inorganic matter” classification. The *Landshire* court rejected the insured’s argument and held that: “The presence of Listeria monocytogenes in Landshire’s food products plainly rendered the food unfit for consumption, and as such meets the ordinary, unambiguous definition of ‘contaminant.’” *Id.* at 532.

Other courts, however, have rejected applying the pollution exclusion to “non-environmental” losses. For example, when faulty raw ingredients were used in Mountain Dew and Diet Pepsi products, the losses associated with the destroyed products were covered despite the pollution exclusion that read: “This policy does not insure against loss, damage, costs or expenses in connection with any kind or description of seepage and/or pollution and/or contamination . . . .” *Pepsico, Inc., v. Winterthur Int’l Am. Ins. Co.*, 13 A.D.3d 599, 788 N.Y.S.2d 142 (N.Y. App. Div. 2004). The court held that New York courts prefer a common-sense approach rather than a literal approach when interpreting this pollution exclusion and limited its application to environmental-type harms.

Similarly, in *Motorists Mutual Ins. Co. v. Hardinger*, 131 Fed. Appx. 823, 827 (3rd Cir. 2005), the court noted that there is no Pennsylvania case law

identified by the parties that addresses whether bacteria should fall within the definition of “pollution.” The court noted that in fact, courts that have addressed whether bacteria fits under similar pollution exclusions are divided. *Compare Keggi v. Northbrook Prop. and Cas. Ins. Co.*, 13 P.3d 785 (Ariz. Ct. App. 2000) (holding that bacteria does not constitute a pollutant under an identical pollution exclusion clause) and *E. Mut. Ins. Co. v. Kleinke*, Index # 2123-00, RJI # 0100062478 (N.Y. Super. Ct. Jan. 17, 2001) (holding that similar pollution exclusion is ambiguous on whether E. coli bacteria falls within the policy’s definition of pollutant) with *Landshire, supra* (“bacteria, when it renders a product impaired or impure” falls within “the ordinary, unambiguous definition of ‘contaminant’”). Accordingly, the court ruled that the issue of whether bacteria fall under the plain meaning of the pollution exclusion or whether the pollution exclusion is ambiguous as applied to the facts of this case should be left to the District Court in the first instance, and directed the trial court to consider whether the pollution exclusion applied to the presence of E. coli bacteria.

#### **F. Governmental Action Exclusion**

First-party policies commonly exclude coverage for loss or damage that is caused directly or indirectly by seizure or destruction of property by order of governmental authority. In food-contamination cases, government entities such as the FDA often issue orders requiring a company to halt the shipment of a product or to recall a product. When this occurs, companies often respond by not only halting the shipment but by also destroying the product.

In first-party coverage cases, the majority of courts have taken a more literal approach to the governmental action exclusion. To apply the exclusion, courts generally require that the governmental body specifically order the seizure or destruction of property. *See Stanley Duensing v. The Traveler’s Companies*, 849 P.2d 203 (Mont. 1993) (where exclusion applied to loss or damage caused by seizure or destruction of property by order of governmental authority, a government-ordered embargo was not the equivalent of a seizure of property and, as such, the exclusion did not apply); *see also Townsends of Arkansas, Inc. et. al. v. Miller Mutual Ins. Co.*, 823 F. Supp. 233 (D. Del. 1993) (governmental action exclusion did not apply where insured voluntarily destroyed its product and there was no governmental body that ordered the seizure or destruction of the insured’s product).

#### **G. Faulty Workmanship Exclusion**

Faulty workmanship exclusions generally exclude coverage for losses or damages that result from errors in design, faulty workmanship or faulty materials. In *General Mills Inc. v. Gold Medal Ins. Co.*, the insurer asserted that losses resulting from contaminated oats intended for cereal products were excluded because the oats were faulty materials. The court rejected this approach and held that the exclusion refers to materials for construction of property, not raw stock

for making cereals products. The court arrived at its conclusion by observing that “faulty materials,” when grouped with “design” and “faulty workmanship,” implies material for the construction of property. *General Mills Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147, 152 (Minn. 2001); *see also Pillsbury Co. v. Underwriters of Lloyd’s, London*, 705 F.Supp. 1396 (D. Minn. 1989) (faulty workmanship exclusion applies only to the losses related to “making good” the defect and not to losses caused by the defect); *but see Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 93 Cal. Rptr. 2d 364, 377 (Cal. Ct. App. 2000) (holding that the presence of wood splinters in the diced roasted almonds caused property damage to the nut clusters and cereal products in which the almonds were incorporated, noting that “we see no difficulty in finding property damage where a potentially injurious material in a product causes loss to other products with which it is incorporated.”).

#### **H. Virus or Bacteria Exclusion**

The American Association of Insurance Services (“AAIS”) is a national advisory organization that develops policy forms and rating information used by more than 600 P/C companies throughout the U.S. The AAIS has recently approved a “Virus or Bacteria” exclusion for its Agricultural Output Program (“AgOP”). This mandatory countrywide exclusion clarifies that there is no first-party property coverage under AAIS forms for loss, cost, or expense caused by, resulting from, or relating to any virus, bacterium or other microorganism that causes or is capable of causing disease, illness or physical distress. The exclusion was developed in light of the possibility of a pandemic of avian flu. However, it may have applicability to contamination claims from any disease-causing agent, including, but not limited to, SARS, rotavirus, listeria, legionella and anthrax.

The virus or bacteria endorsement is being filed with a proposed effective date of May 1, 2007 in most states under the following AAIS programs: Agricultural Output; Artisans; Businessowners; Commercial Inland Marine; Commercial Output; COP-XL; Commercial Properties; Developers Output; Farmowners; Farm Properties; and Inland Marine.

#### **IV. Directors and Officers Coverage**

Traditional product liability and products recall lawsuits brought against manufacturers or processors of allegedly tainted food would not likely find coverage under the company’s D&O policy. Those policies typically provide “entity coverage” only in instances where the company is sued for securities violations. Notwithstanding, and even if the suits were to name company managers or executives, most D&O policies contain exclusions for claims arising out of personal or bodily injury.

Of course, there remains the possibility that food manufacturers and their directors or officers could be targeted by their own shareholders in instances where the company’s stock is adversely affected by mass food contamination

situations, in which cases the company's D&O coverage may be implicated. For example, a class of plaintiffs might allege that the directors or officers of a publicly-traded food company engaged in securities fraud and misled investors by failing to timely disclose known potential contamination issues that would have materially affected the company's financial statements. Also, shareholders of the food company could allege, under certain circumstances where there exist strong indicators of prior, high-level knowledge of contamination issues, that the directors or officers of the company breached their fiduciary duties to shareholders by not doing enough to protect the company from the potential liability and fall-out from a mass contamination incident. These are classic examples of securities and derivative allegations which might call D&O policies into play where a company becomes embroiled in a vast food contamination scandal.

## **V. Specialty Policies**

### **A. Product Recall Coverage**

The recall of a product is the most extreme action a company can take when faced with a contamination event. A company's decision to recall a product depends on a number of factors, including the nature of the problem/contamination; the potential harm to consumers from the contaminated product; the potential role of federal, state or international regulatory agencies; and the overall cost of the recall in comparison with other less expensive alternatives. Companies tend to focus on exposure arising from the direct costs of responding to a recall. As a result, potential exposure from indirect costs, measured in terms of consumer confidence and company credibility, can often be overlooked.

Most companies are aware of the need to maintain some type of products-liability insurance coverage. What they may not be aware of are the limitations of this coverage when a product recall is required to contain an emergency, as well as the major variations in the terms of specialized product recall policies. As a general principle, insurance policies covering general product-liability risk do not usually insure the costs of implementing a product recall of an unsafe or contaminated product.

In light of the various gaps in third-party and first-party policies discussed above and in order to tailor standard coverage to the specific needs of the food industry, specialty insurance policies, like contaminated products policies, trade disruption policies or product recall policies, have been developed.

The advent of product recall insurance began in the late 1980s as a result of the well known and publicized Tylenol tampering incident. In that case, a number of Tylenol bottles were intentionally laced with cyanide. As a result, seven people died. The manufacturer ultimately paid over \$100 million in remedial costs. After this incident, a few insurers began offering recall insurance for malicious or intentional tampering. Recall insurance stemming from accidental contamination

began appearing in the early 1990s. And in 2004, the Insurance Services Office (“ISO”) approved a standard form for product recall insurance.

The product recall policy is a specialized policy underwritten to meet the unique needs of insureds who are in the food distribution process. Although these policies are available, product recall policies are not widely issued. This is attributed to the relatively small number of insurers actually providing this coverage and the limited information and/or knowledge that insurance brokers have regarding the scope of coverage under the product recall policies.

Policies designed to cover the costs associated with a product recall, product tampering, product rehabilitation, and related expenses are available through a handful of markets. Most product recall policies are not standard ISO forms and, as such, the terms of the policies can vary widely from policy to policy. In general, however, the product recall policies cover the costs of inspecting, withdrawing, destroying, and replacing contaminated products. In addition, product recall policies may provide coverage for related expenses for product rehabilitation, crisis management and lost profits.

In the last couple of years, several insurers have announced the availability of specialized product recall policies. For example, in 2006, an international insurer announced its new primary food and drink product contamination insurance, which includes integrated crisis management cover. This insurance not only covers costs associated with a product recall, but also places an emphasis on risk prevention and emergency response. Included in the premium is a free initial consultation with crisis managers, as well as an allocation for risk improvement work such as recall and crisis planning. For this program, the insurer has teamed up with specialist consultancies based in the U.K. and U.S. offering expertise in areas such as public relations, product security, laboratory services and regulatory advice. In the event of a contamination, the insurance gives policyholders priority access to the consultants.

A major domestic insurer in the U.S. offers a RecallResponse product which includes coverage for first-party expenses and third-party liability arising from the recall of finished or component goods. The RecallResponse policy is provided as a supplement to the insurer’s product liability insurance. RecallResponse can cover product recall expenses alone or can be expanded to cover liability to third parties arising from the recall. Expenses associated with extra warehousing and extra personnel to support a recall can be insured as well.

Another major domestic insurer offers a suite of product recall coverages in one insurance form. The insurer’s product recall policy includes coverage for the cost of withdrawing the defective product, communications expenses related to the recall, overtime costs and hiring of temporary employees, good faith advertising to rehabilitate the product’s reputation, third-party recall expenses and an optional

extension of coverage to reimburse for expenses relating to the repair, replacement or remanufacturing of the defective product.

At the present time, product recall policies are not widely distributed. However, with time, it is likely that a growing awareness of the existence of such policies (by both policyholders and brokers) coupled with the advent of widely publicized contamination scares will increase the circulation of these specialized policies.

## **VI. Conclusion**

The above decisions provide important guidance with respect to coverage issues often raised with food contamination claims. Cozen O'Connor continues to opine, litigate and monitor the many coverage issues involved with food contamination claims. Our team of food contamination coverage attorneys are prepared to provide immediate, effective assistance. Through meetings, conference calls, seminars, coverage alerts and the preparation of papers and articles, Cozen O'Connor is prepared to assist clients effectively handle the next food contamination claim.

## VII. Contributing Authors

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