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FOOD INSURANCE LAW: NOTABLE CASE DEVELOPMENTS

By: Robert D. Chesler, Esq., Michael David Lichtenstein, Esq., Joseph D. Jean, Esq., and Rachel M. Wrightson, Esq. August 2011

Product Recall I: The Product Recall and Impaired Products Exclusions

What happens when your product causes another product to be recalled? *Security National Insurance Company v. GloryBee Foods, Inc.*, No. 09-1388-HO, 2011 U.S. Dist. LEXIS 27267 (D. Or. Mar. 15, 2011), concerns this common insurance issue. There, GloryBee Foods, Inc. ("GloryBee"), sold 80,000 pounds of roasted peanuts to Nature's Path Foods ("Nature's Path"). Critically, the peanuts were incorporated into Nature's Path product in such a way that they could not be removed without damaging that product. When GloryBee's peanuts were recalled, Nature's Path's product had to be recalled. Nature's Path sued GloryBee for its damages. GloryBee gave notice of the claim to its insurer, Security National Insurance Company, under its general liability insurance policy, and Security commenced litigation against GloryBee, asserting that the policy's product recall exclusion barred coverage.

The court noted that the product recall exclusion, when read in isolation, could reasonably be construed to bar coverage for Nature's Path's claim. The court, however, then looked to what is known as the "impaired product" exclusion. This exclusion applies to defective components that are incorporated into a product, if the defect can be cured simply by replacing the component. Because GloryBee's peanuts were incorporated into Nature's Path's product in such a way that the peanuts were inextricably intertwined with the product and could not simply be removed and replaced, the court found that the impaired property exclusion did not apply. The court reasoned that the insurance company could have drafted the exclusion to bar coverage for any defective component, whether or not it could be removed. Ultimately, the court read the product recall and impaired product exclusions together, and found that the recall exclusion did not apply.

Product Recall II: The Communicable Disease and Fungi and Bacteria Exclusions

Camden Fire Insurance Association v. Mincing Trading Corporation, No. L-3955-10 (N.J. Sup. Ct.), concerned a spice importer who had to recall products because of a suspicion of salmonella contamination, which resulted in destruction of the products of its customers who had incorporated the spice into their products. When Mincing gave notice of the customers' claims to Camden, Camden filed suit seeking a declaration that it had no coverage obligation.

Camden relied on the "communicable disease" exclusion in its policy, arguing that salmonella was a communicative disease and that coverage was therefore excluded. However, the court noted that the policy also had a "fungi and bacteria" exclusion, which would also apply to salmonella. However, this exclusion had an exception for fungi or bacteria "that are, are on, or are contained in, a good or product intended for consumption."

The court found that the two exclusions were in conflict, and that the bacteria and fungi exclusion, as the more specific exclusion, took precedence. Since the exception to the exclusion applied to the allegedly contaminated spice that was placed into food products, the court found that coverage existed.

The court also noted that the Camden policy was entitled "@vantage for Food Industries" and was specifically

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designed to protect companies in the food industry. The court found that it would be objectively reasonable for a food company that purchased an insurance policy designed specifically for the food industry to provide coverage for salmonella contamination.

Failure to Warn

Hartford Fire Insurance Company v. Chartis Specialties, et al., No. 652008/2011 (N.Y. Sup. Ct.) is a recently filed complaint by Hartford against its insured, Topco Associates, LLC ("Topco"), and Topco's other insurers. This complaint demonstrates how food companies can get caught in a whipsaw between new liabilities and old insurance policies.

The underlying case, *Littlefield v. Del Monte Corporation,* et al., Case No. 1:10-cv-12200 (D. Mass.) was a class action against eight juice manufacturers, including Topco. The plaintiff alleged that the juices in question contained lead. As a result, the plaintiff sued, *inter alia,* under the California Safe Drinking Water and Toxic Enforcement Act of 1986, which prohibited a company from knowingly exposing a consumer to toxic chemicals without providing a "clear and reasonable warning." The plaintiff alleged that the Environmental Law Foundation had earlier notified the defendants that their products contained lead.

The class action did not allege that the lead caused any bodily injury, nor did it seek any damages for any injury. The *Littlefield* suit did not allege false advertising, but rather just a failure to include a warning. The suit sought only injunctive relief, corrective advertising, refunds, other consequential damages and, of course, attorneys fees.

As a result, when Topco turned to its insurer for coverage, it was met with a complaint seeking a declaration that no coverage existed because the *Littlefield* suit did not allege bodily injury or property damage.

Property Insurance: The Contamination Exclusion

The above three cases all concerned third parties' claims against the insured that resulted in claims by the insured under its liability policy. *Leprino Foods Company v. Factory Mutual Insurance Co.,* Nos. 09-1262, 09-1287, 2011 U.S. App. LEXIS 15400 (10th Cir.), concerned a claim under a property policy for damage to the insured's own property. As is often the case with food claims, the insurer denied coverage because of the contamination exclusion in its policy.

Leprino Food Company ("Leprino") stored over eight million pounds of cheese in a third-party warehouse. In 2001, Leprino received reports that the cheese had an off odor and off flavor, rendering it unusable. The problem was traced to conditions at the warehouse. Leprino made a claim under its first-party property policy. Factory Mutual Insurance Company denied coverage based on the contamination exclusion.

A property policy contains two types of exclusions. One set of exclusions is absolute. If damage is caused by certain causes, there is no coverage, regardless of the nature of the loss. A property policy also includes contingent exclusions, of which the contamination exclusion is one. Pursuant to this type of exclusion, there is no coverage for the contamination, unless the contamination was caused by other physical damage.

Thus, in *Leprino,* coverage would not exist if ordinary conditions in the warehouse resulted in contamination. Coverage would exist if the contamination was caused by other physical damage in the warehouse. *Leprino* met this "other physical damage" burden by demonstrating that damaged fruit in the warehouse caused the contamination of its cheese.

One to Watch: *PBM Nutritionals, LLC v. Lexington Ins. Co.*

In *PBM Nutritionals, LLC v. Lexington Ins. Co.,* No. 09-5289, 2011 Va. Cir. LEXIS 16 (Va. Cir. Ct., Jan. 7, 2011), a Virginia circuit court issued an opinion and order finding that ACE American Insurance Company ("ACE") and Arch Insurance Company ("Arch") owed no coverage to PBM Nutritionals, LLC ("PBM"), on its claim for roughly $6 million in product contamination losses. Central to the holding was the court's determination that two exclusionary endorsements added to the manuscript form by ACE and Arch applied to product contamination losses.

The dispute in PBM Nutritionals arose from contamination that occurred during manufacture of infant formula. Specifically, PBM discovered that a leaking valve had allowed steam to enter a heat exchanger while it was shut down for cleaning. The steam superheated water, which melted a filter assembly, the components of which were then released into the water. When PBM restarted its manufacturing process, it mixed the contaminated water with other infant formula ingredients. PBM quarantined and disposed of the formula after FDA-mandated tests revealed the presence of contaminants, and it then sought coverage for the loss.

PBM's property insurers denied the claim, however, and litigation ensued. At trial, PBM contended that

the policies covered physical losses to personal property such as the water filters, and that contamination resulting from the loss of the filters qualified as an exception to the perils excluded. PBM's policies also included a so-called perils excluded section denying coverage for damages caused by the discharge of pollutants unless the discharge is caused by a so-called peril insured against.

The court, however, found no liability for coverage for the contamination losses, only finding ACE and Arch liable for the cost of replacing water filters involved in the incident, an expense that amounts to $7,267. The court did not find ambiguity in the coverage inconsistencies between the perils excluded section asserted by PBM and the pollution and contamination endorsements. Rather, according to the court, the endorsements modified the section.

On July 28, 2011, the Virginia state Supreme Court granted PBM's request for appeal on the following: whether the court erred (1) in construing "two directly conflicting policy provisions in favor of the insurers and not the insured, in violation of established precedent"; (2) "refusing to limit the insurers' Pollution Exclusion Endorsements to traditional environmental contamination losses"; (3) by implicitly assuming that PBM's multimillion-dollar infant formula loss was a "contamination loss" when the insurers offered no evidence that the infant formula was "contaminated" and when, in fact, the court found that most of the batches of infant formula did not exceed FDA melamine limits.

Take-Aways

1. Your insurance company will sue you. In all three of the liability insurance cases, the insurer was plaintiff.

2. No one can guarantee a quick resolution of a coverage case. In *Leprino,* the decision by the Tenth Circuit came ten years after the loss.

3. Insurance coverage claims are highly technical. A company that suffers a loss should consult experienced coverage counsel.

4. Insurance coverage law is slanted in favor of the policyholder. Almost every state recognizes that insurance policies are not negotiated but rather are drafted solely by the industry. As a result, insurance policies are construed in favor of coverage, and a court will enforce the objectively reasonable expectations of the insured.

Insurance 101: NOTICE! NOTICE! NOTICE!

The single most important thing to know about insurance coverage is to give notice promptly and broadly to your insurance company of anything that even smells like a claim. Under most new insurance policies, such as D&O and employment policies, failure to give notice of a claim during the policy period in which you received the claim is normally fatal to coverage. Under general liability policies, failure to provide notice can also result in forfeiture of coverage, particularly if late notice has prejudiced the insurer. Under new contamination/product recall policies, any delay in notice after learning of the problem can be fatal.

Most companies (hopefully) know to provide notice to their insurer if they receive a complaint. However, many policies now require notice of a "claim," and definitions of a claim can be extremely broad. One frequent definition is "any written demand for monetary or nonmonetary relief." Moreover, under most types of insurance policies, the insured upon applying for the policy must provide notice of any circumstances likely to give rise to a claim.

On the one hand, the broad definition of "claim" substantially increases the available coverage and compels insurers to step in and pay defense costs long before a complaint is filed. However, the downside is that failure to provide notice of a claim can easily cost you the coverage for which you paid premiums and upon which you depend. If you have any questions about whether to provide notice, consult an attorney or insurance professional. If you are not sure about whether to give notice, err on the side of providing notice.

Please contact any of the following attorneys in Lowenstein Sandler's Insurance Law Practice Group with questions related to this alert or other insurance coverage issues:

Robert D. Chesler
973 597 2328
rchesler@lowenstein.com

Michael David Lichtenstein
973 597 2408
mlichtenstein@lowenstein.com

Joseph D. Jean
646 414 6906
jjean@lowenstein.com

Rachel M. Wrightson
646 414 6912
rwrightson@lowenstein.com

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