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Expert Analysis

Upset Stomachs, Upset Customers and Upset Policyholders: *Insurance Recovery For Food and Beverage Companies*

By Marc S. Mayerson, Esq.
Orrick, Herrington & Sutcliffe

Participants in the food production and distribution business today face a significant risk of liability. No matter how careful they are in their own processes, they can get caught up in circumstances created by their competitors, and these circumstances may affect their businesses adversely.

Pet-food manufacturers have faced liability because of ingredients from China. Beverage makers have faced claims for benzene contamination. Spice makers have colored their products with a dye that was not approved by the Food and Drug Administration, leading to big losses. Fresh-greens processors have seen severe shifts in consumer-buying habits after adverse media reports about an outbreak of contamination-related sickness.

Agribusiness worries about downstream claims. Baby-formula manufacturers can see national chains remove their products from their shelves because of fear of contamination. Fresh sprouts turn into vectors of disease. Incidents of contamination at a restaurant affect grocery sales and vice versa.[1]

In response to this maelstrom, insurance companies have offered to sell various kinds of insurance policies. They promise to smooth out financial bumps from liability events in exchange for substantial premiums, and they promise to help manage a crisis, including the cost of product recalls due to a contamination event.

A recent survey showed that food, beverage and agribusiness companies on average are purchasing more than $130 million in excess insurance coverage limits annually and another $19 million in specialized product-recall and contamination insurance limits (up to $210 million by the largest purchasers).[2]

As eager as underwriters are to collect premiums, are the insurance company claims-handlers as eager to pay claims?

It is hard to assess how frequently corporate policyholders receive claim denials – or have their claims paid voluntarily by their insurers. There are no statistics about satisfied customers who received full payments or disgruntled customers who simply

elected not to pursue an erroneously denied claim, or who switched insurers after an unfavorable claim decision.

However, scanning the advance sheets of reports of coverage disputes leaves the impression of a pattern of claim denials affecting all sectors that are affected by food contamination. Worse than "merely" not paying, insurers sometimes pursue the aggressive tactic of suing their own policyholders for a declaratory ruling of no coverage or for rescission of insurance policies on grounds of misrepresentation or inadequate disclosure in the underwriting process.

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No doubt, insurance companies sometimes are right that a particular policy does not provide coverage for a particular claim. But the frequency of coverage disputes shows that policyholders expected that they had insurance coverage for these events, induced in part by the names of the policies for which they paid (see box).

For example, in *Little Lady Foods Incorporated v. Houston Casualty Company*,[3] the frozen pizza and sandwich producer that earned $300 million per year sought insurance recovery for nearly 60,000 cases of product that it had quarantined after a bacteria test was positive for listeria species but not specifically *L. monocytogenes*, the human pathogen.

Later, an assay for the pathogenic bacterium proved negative, but the delay impinged on the ordinary shelf life of the product. Little Lady decided to destroy a portion of the product and sell a percentage to the secondary market at a substantial discount.

Little Lady turned to its insurer under a policy providing coverage for "accidental or unintentional contamination." However, because there was *no actual contamination*, the insurer denied coverage, and the court upheld the insurer's no-coverage decision. (The matter is presently on appeal.[4])

A similar result occurred in *Fresh Express v. Beazley Syndicate 2623/623 at Lloyd's*,[5] in which the court likewise found there was no coverage for more than $50 million of costs associated with a recall of bagged fresh spinach. Nearly six years ago, a major *Escherichia coli* contamination was discovered in bagged spinach, albeit not in the products of Fresh Express.

Coverage offered to the food industry:

- TotalRecall+
- Malicious Product Tampering/Accidental Product Contamination
- Spoilage and Contamination Extension
- Contaminated Products Insurance
- Recall Ready
- Response
- Broad Form for adulterated or contaminated ingredients
- Communicable disease

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The FDA had contacted Fresh Express and other companies that sold bagged spinach and urged them to take steps to check and recall their products; at the same time, the FDA issued a general "no consumption advisory" for consumers of all bagged spinach, because the source of the outbreak had not yet been traced. Food retailers nationwide removed bagged spinach from their stores; consumers were told to dispose of whatever bagged spinach they might have in their refrigerators. In response, Fresh Express "decided to stop harvesting, processing, and distributing spinach products due to the FDA advisory and the resulting loss of public confidence in spinach products."[6]

Although the particular source of the contamination turned out to be one of the company's competitors, a couple of incidents in Kentucky raised the suspicion (later disproved) of a link to the product of Fresh Express. Fresh Express undertook a super scrub of its manufacturing equipment, and its quick response team conducted an internal investigation of its sourcing.

In the midst of this industry-wide crisis, Fresh Express filed a claim with its insurer under its "TotalRecall+" policy. The insurer denied coverage, and the California Court of Appeals upheld the denial.

As the court reasoned: "While 'the E. coli outbreak' itself may have given Fresh Express cause to believe that its products were contaminated, 'the E. coli outbreak' was not an '[e]rror by [Fresh Express]' so it could not qualify as 'accidental contamination' and thereby [is not covered as] an 'Insured Event' under the policy."[7]

As a factual matter, the court ruled that "neither the E. coli outbreak nor the FDA's advisory *arose from* Fresh Express's errors. The sole cause of the E. coli outbreak and the FDA advisory was [a competitor's] contaminated spinach, not any errors by Fresh Express."[8]

The frequency of disputes shows that policyholders expected that they had insurance coverage, induced in part by the names of the policies for which they paid.

A result that was similar to those in *Fresh Express* and *Little Lady* was adopted by the court in *Caudill Seed & Warehouse Co. v. Houston Casualty Co.*[9] In that case, the court held that coverage did not apply because the company merely had used contaminated peanuts in its products – it had not *caused* the contamination through its own manufacturing process. In another pro-insurer case, a food company refused to use the defective cans that the policyholder, Silgan Containers Corp., manufactured, and then the food company disposed of already-packaged product that had been packaged in the cans.[10] The court found that the can manufacturer made an insufficient showing because merely defective cans (that did not open easily and had other flaws) did not indicate actual contamination of the contents – so coverage did not apply.

Where actual contamination has been proved, in contrast, courts tend to find coverage. For example, in *Security National Insurance Co. v. GloryBee Foods Inc.*,[11] the court rebuffed the carrier's suit for a declaration of no coverage when contaminated peanuts ended up in the policyholder's food product. There was actual damage; thus, neither the impaired-property exclusion nor the products-recall (or sistership) exclusion applied.[12]

WITH FRIENDS LIKE THESE

For more than a decade, insurers have aggressively marketed brand-protection insurance policies, noting that "[p]roduct contamination, whether deemed accidental or malicious, is considered to be the most serious risk to corporate reputation."[13]

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There is a disconnect, however, between the desires of policyholders to have broad coverage against the risk of food-product recalls and to safeguard brand integrity and the insurers' position that only in the rare instances in which there is actual contamination from the insured's operations does coverage apply.[14]

Paradoxically, the outcomes of the coverage cases and the positions of the carriers create the incentive on the part of the policyholder to prove that its conduct was indeed the source of actual contamination. When it does so, however, the policyholder risks magnifying its underlying liability because it may lose the economic-loss defense to tort claims asserted by its customers, and consequently the limitations of liability established under contract.[15]

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CONCLUSION

Policyholders need to scrutinize insurance policies before buying them to assess whether they will protect the insured's more general interest in the integrity of its brand or whether the coverage marketed as being broadly protective instead is narrowly drafted to require the insured to prove that its operations caused actual contamination of foodstuffs. Beverage makers, pet-food manufacturers, meat-product companies, frozen-food companies, produce packers, farmers and retailers all need to consider the position insurance companies are asserting at the point of claim and whether the insurance products they are purchasing actually provide the coverage they seek.

NOTES

1 Terms that food growers and processors, pet food makers, restaurants, retail businesses, and cheese makers and sellers need to know are: salmonella, Escherichia coli, listeria, staphylococcus, Clostridium botulinum, allergens, sulfites, gluten, histamine, campylobacter, aflatoxin, cyclosporine, cryptosporidium, toxoplasma, ochratoxin A, Vibrio cholerae, V. vulnificus, hepatitis A, norovirus, shigella, bovine spongiform encephalopathy, Creutzfeldt-Jakob disease, Guillain-Barré syndrome, hemolytic-uremic syndrome, reactive arthritis, melamine, acrylamide, furan, ethyl carbamate, fumonisin, 3-MCPD (3-monochloropropane-1,2-diol) and 4-HNE (4-hydroxy-2-nonenal).

2 Aon Risk Solutions, 2011 U.S. Industry Report: Food System, Agribusiness and Beverage.

3 No. 10-C-8280, 819 F. Supp. 2d 759 (N.D. Ill. 2011).

4 No. 10-C-8280, *notice of appeal filed* (N.D. Ill. Oct. 20, 2011).

5 199 Cal. App. 4th 1038, 131 Cal. Rptr. 3d 129 (Cal. Ct. App., 6th Dist. Sept. 8, 2011), *review denied* (Jan. 11, 2012), *as modified on denial of reh'g* (Oct. 4, 2011).

6 *Id.*

7 *Id.*

8 *Id.*

9 No. 3:10-CV-299-JHM, 2011 WL 6370366 (W.D. Ky., Louisville Div. Dec. 20, 2011).

10 *Silgan Containers Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.,* No. C-08-2246 PJH, 2010 WL 1267127 (N.D. Cal. Mar. 29, 2010) *aff'd sub nom., Silgan Containers Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.,* 434 F. App'x 709 (9th Cir. 2011), *cert denied*, 132 S. Ct. 602 (U.S. 2011).

11 *Sec. Nat. Ins. Co. v. GloryBee Foods,* No. CIV-09-1388-HO, 2011 WL 902635 (D. Or., Eugene Div. Mar. 15, 2011).

12 *See generally Gulf Ins. Co. v. Parker Prods.,* 498 S.W.2d 676, 679 (Tex. 1973).

13 *Corporate Image in the Food and Drink Industry* (Lloyd's, 2000). "It is primarily the business disruption and negative publicity of the catastrophic food-borne illness or outbreaks that cost firms money. ... In the rare instances where food-borne disease outbreaks are linked to particular firms, the impact on those firms can be large." *See also,* J. Buzby et al. *Product Liability & Microbial Foodborne Illness,* Agricultural Economic Rep. No. 799 (Economic Research Service/USDA Apr.

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2001) at 26; *see also*, Z. Finn *et al.*, *Spoiled Brands: Protecting Your Company's Goodwill and Assets from Food Contamination Claims,* CPCU eJournal (Apr. 2008).

[14] *See HoneyBaked Foods v. Affiliated FM Ins. Co.,* No. 3:08-CV-01686, 2011 WL 834067 (N.D. Ohio., W. Div. Mar. 4, 2011) (certifying to state Supreme Court whether the insured's expectation that coverage was afforded for spoilage trumped policy provisions barring coverage for contamination).

[15] *See Omega Proteins v. Aspen Ins. UK. Ltd.,* [2010] EWHC 2280 (Q.B. Comm. Ct. Oct. 9, 2010) (insurer seeking to avoid coverage based on contractual-liability exclusion; court ruled that the clause "invites consideration as to what liability would have attached in the absence of a contract [which is covered]; not as to what liability in tort would have arisen in the presence of one; nor as to whether there was liability in tort as well as in contract.") (Para. 23).

Marc S. Mayerson of **Orrick, Herrington & Sutcliffe** in Washington advises and represents corporate policyholders in litigation, negotiation and alternative dispute resolution. He wrote the comprehensive article Insurance Recovery for Losses from Contaminated or Genetically Modified Foods.

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