Buyer Beware: Product Recall & Accidental Contamination Coverage

Meghan Magruder, Shelby Guilbert and Jessica Sabbath, King & Spalding

In 2011, President Obama signed the Food Safety Modernization Act (FSMA), granting the FDA expansive powers to protect the nation's food supply. The act shifts the FDA's regulatory focus from reacting to food contamination to prevention.

Insurance companies offer product recall and accidental contamination coverage, either as add-ons to commercial general liability (CGL) policies or as stand-alone products to fill gaps in CGL and first-party property coverage. Product recall policies generally purport to cover crisis management costs; costs associated with the recall itself, such as testing, shipping, storing, disposing of and repairing the product; rehabilitation costs, such as replacing the product and compensating third-parties to whom the company is contractually obligated to deliver the product; and lost profits resulting from the recall.

Given the marketing materials accompanying these products and the high premiums often associated with them, a policyholder may reasonably expect that these policies will protect against risks. In practice, however, coverage under these policies has often proven to be elusive.

The recent case of *Fresh Express Inc. v. Beazley Syndicate 2623/623 at Lloyd's***[1]** *[1]* is illustrative. In that case, after an outbreak of a virulent E. coli strain was traced to bagged spinach, the FDA issued an alert advising consumers not to eat bagged, fresh spinach. Not knowing which company's bagged spinach was responsible for the outbreak, the FDA further recommended that Fresh Express, the nation's largest bagged spinach producer at that time, recall its products.

After the FDA determined the source of the outbreak (which was not Fresh Express's spinach), it recalled the advisory, but not before Fresh Express had suffered a substantial loss of business. Fresh Express sought to recover those losses under its recall insurance policy, but the California Court of Appeals held that Fresh Express was not entitled to coverage, reasoning that Fresh Express's losses were

not caused by “accidental contamination,” which the policy defined as an error by Fresh Express that caused it to believe that use or consumption of its products could result in bodily injury. Because Fresh Express’s losses were not the result of any error on its part, and despite the FDA advisory and recall recommendation, there was no “insured event” triggering coverage under the recall policy.

In *Little Lady Foods, Inc. v. Houston Casualty Company*,[2] [2] a court granted summary judgment to an insurer that denied coverage to Little Lady Foods on similar grounds. Little Lady Foods had purchased a Malicious Product Tampering/Accidental Product Contamination insurance policy that provided coverage for losses resulting from “any accidental or unintentional contamination . . . provided that the consumption or use of [the products] has, within 120 days of such consumption or use, either resulted, or may likely result in . . . bodily injury, sickness, or disease.”

During the operative policy period, Little Lady began to use a new process for producing burrito products sold at convenience stores. Little Lady’s internal company policy and USDA regulations required it to test for harmful bacteria on the new product prior to shipment. These tests revealed that listeria genus was present on six samples. There are seven strains of listeria genus, but only one strain causes illness if consumed.

Because samples of the product tested positive for one of the seven strains, Little Lady performed additional testing, held back shipments of its product, and made a claim under its Accidental Product Contamination policy. Because the burrito product ultimately tested negative for the harmful strain of listeria, the insurer denied coverage on the grounds that the losses did not result from an “accidental product contamination.” Agreeing with the insurer’s denial of coverage, the court concluded that Little Lady’s losses did not fall within the policy’s definition of “accidental product contamination” because none of Little Lady’s products was actually contaminated with harmful bacteria, and there was no possibility that consumers could be harmed.

Similarly, a court granted an insurer’s motion for summary judgment in *Caudill Seed & Warehouse v. Houston Casualty Company*.[3] [3] The recall coverage claim in that case arose when the FDA informed Caudill Seed that products made from contaminated peanuts that Caudill Seed had purchased and processed into peanut butter “posed an acute, life-threatening hazard to health.” The FDA approved of Caudill Seed’s decision to recall such products, but Caudill Seed’s insurer denied coverage under Caudill Seed’s Accidental Product Contamination policy on the ground that it “did not demonstrate that the products were actually contaminated” as required under the policy. A court agreed with the insurer, reasoning that because the FDA found that the peanuts were contaminated when Caudill Seed purchased them, the impairment of the peanuts did not occur “during the manufacture, blending, mixing, compounding, packaging, labeling, preparation, production or processing of the Named Insured’s PRODUCTS” as the policy required.

These decisions raise questions about whether specialty food recall products currently on the market are designed to insure against risks in a new era of

heightened regulatory scrutiny for the food industry. It is important to remember that insurance policies are negotiable, and policyholders seeking to maximize their coverage should always attempt to negotiate policy language. Given the high premiums that product recall and accidental contamination policies command, it is all the more important to work with experienced counsel to negotiate the most favorable policy language possible to maximize coverage in the event of a loss.

Meghan Magruder *is a Senior Partner in King & Spalding's Atlanta office and a member of the Business Litigation Practice Group. Ms. Magruder has 30 years of experience handling complex commercial litigation matters with particular emphasis in insurance coverage, contract and indemnity disputes, mass tort defense and product liability litigation.*

Shelby Guilbert *is a Counsel at King & Spalding in the firm's Business Litigation and International Arbitration Disputes Practice. He represents large businesses and corporations in insurance coverage disputes, complex commercial litigation, and appeals in state and federal courts and domestic and international arbitration.*

Jessica Sabbath *is a senior attorney in the firm's Business Litigation Practice Group. Her practice involves a wide range of complex commercial litigation, with a focus on real estate disputes, business torts, contract disputes, and insurance coverage disputes.*

[1] [4] 131Cal. Rptr. 3d 129 (Ct. App. 2011).

[2] [5] No. 10 C 8280, 2011 WL 4473517 (N.D.Ill. Sept. 22, 2011).

[3] [6] No. 3:10-cv-299-jhm, 2011 WL 6370366 (W.D.Ky. Dec. 20, 2011).

Links:
[1] file:///C:/Users/kgabert/AppData/Local/Microsoft/Windows/Temporary%20Internet%20Files/Content.IE5/0Q9QW8YL/Buyer%20Beware%20Product%20Recall%20&%20Accidental%20Contamination%20Coverage.doc#_ftn1
[2] file:///C:/Users/kgabert/AppData/Local/Microsoft/Windows/Temporary%20Internet%20Files/Content.IE5/0Q9QW8YL/Buyer%20Beware%20Product%20Recall%20&%20Accidental%20Contamination%20Coverage.doc#_ftn2
[3] file:///C:/Users/kgabert/AppData/Local/Microsoft/Windows/Temporary%20Internet%20Files/Content.IE5/0Q9QW8YL/Buyer%20Beware%20Product%20Recall%20&amp

;amp;%20Accidental%20Contamination%20Coverage.doc#_ftn3
[4] file:///C:/Users/kgabert/AppData/Local/Microsoft/Windows/Temporary%20Internet%20Files/Content.IE5/0Q9QW8YL/Buyer%20Beware%20Product%20Recall%20&%20Accidental%20Contamination%20Coverage.doc#_ftnref1
[5] file:///C:/Users/kgabert/AppData/Local/Microsoft/Windows/Temporary%20Internet%20Files/Content.IE5/0Q9QW8YL/Buyer%20Beware%20Product%20Recall%20&%20Accidental%20Contamination%20Coverage.doc#_ftnref2
[6] file:///C:/Users/kgabert/AppData/Local/Microsoft/Windows/Temporary%20Internet%20Files/Content.IE5/0Q9QW8YL/Buyer%20Beware%20Product%20Recall%20&%20Accidental%20Contamination%20Coverage.doc#_ftnref3