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Insurance Challenges For Food And Supplement Manufacturers

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Manufacturers of food and dietary supplement products continue to face challenges in recovering for common types of claims and losses under their insurance programs. The insurance industry has limited or excluded coverage for some of these risks under "traditional" first-party and third-party insurance policies and has channeled them to lower "sublimits" or to new policies. This has happened with pollution, product recall and cyberinsurance risks.

The result, as shown by the recent decisions discussed below, is that policyholders may find they have losses or liabilities that are excluded from traditional policies but which don't trigger coverage under newer policies ostensibly designed to capture excluded risks. We offer a takeaways from some recent cases that can be considered by policyholders placing or renewing their coverage.

Coverage Narrows Under General Liability Policies

Wisconsin Supreme Court Holds that Incorporation of the Wrong Ingredient into a Supplement Product is not Covered

In Wisconsin Pharmacal Co. LLC v. Nebraska Cultures of California Inc., 2016 WI 14 (March 1, 2016) the insureds supplied the wrong probiotic ingredient to another manufacturer, which then combined it into tablets with other ingredients and sold the complete tablets to pharmacy wholesaler Wisconsin Pharmacal. When the mistake was discovered, Pharmacal recalled and destroyed the shipment of tablets and sued the probiotic suppliers and their insurers. The suppliers sought coverage for their defense and indemnity costs under their general liability insurance policies, which cover liability for third party "property damage" arising out of an "occurrence."

In a 3-2 decision the Wisconsin Supreme Court held that the tablets incorporating the ingredient were an "integrated system" that could no longer be distinguished or separated from the ingredients and that no "other property" had been damaged.

The third justice dissented sharply, explaining that general liability insurance policies — including the policies at issue in Pharmacal — expressly *allow* coverage for damage involving "integrated systems." The policies' "impaired property" exclusion, which bars coverage if the "impairment" can be remedied by "repair, replacement, adjustment or removal of '[the insured's] product' or '[the insured's] work," *but includes* coverage if the impaired property cannot be restored to use. Slip op. at 141-143

(Abrahamson, J., dissenting). In other words, once a faulty ingredient has been blended with a third party's ingredients and cannot be removed from the integrated product, coverage is *preserved*, not excluded, by this policy provision. See Armstrong World Industries Inc. v. Aetna Casualty & Surety Co., 45 Cal. App. 4th 1, 92-94 (Cal. Ct. App. 1996) (finding third-party property damage where insured's asbestos was installed in a third party's building); Shade Foods Inc. v. Innovative Products Sales & Marketing Inc., 78 Cal. App. 4th 847, 865-66 (Cal. Ct. App. 2000) (finding third-party property damage where insured's nut clusters containing wood splinters were incorporated into customer's breakfast cereal product).

Takeaway: Although the Pharmacal decision is inconsistent with the policy language and with other decisions concerning coverage for incorporation of defective products, courts in other jurisdictions might be influenced by it. Policyholders should take into account the law that might govern any coverage dispute. In addition, insureds should consider whether their general liability policies can be endorsed to clarify that damage to third-party products that incorporate the insured's ingredients is covered.

Michigan Federal Court Finds that an Insured Supplement Manufacturer was not Covered for Competitor's False Advertising Claim

Bausch & Lomb advertised its own supplement as the only supplement that provides certain vitamins recommended for macular degeneration by a National Institue of Health study. The insured, Vitamin Health, advertised its competing product as compliant with that NIH study. Bausch & Lomb sued insured Vitamin Health for patent infringement and false advertising.

The court held that there was no coverage because the claim did not allege advertising injury and because multiple exclusions applied. Vitamin Health Inc. v. Hartford Casualty Insured Co., No. 15-10071 (E.D. Mich. May 9, 2016).

The court held that Vitamin Health had never made any claims about Bausch & Lomb's competing product and therefore there was no explicit or implicit "product disparagement" to trigger the advertising injury coverage of Vitamin Health's policy. The court also commented that coverage was barred by the exclusion for any suit that includes an allegation of intellectual property infringement, regardless of whether other allegations are made. The court concluded that the exclusion applicable to injury "arising out of the failure of goods, products or services to conform with any statement of quality or performance made in your 'advertisement'" also applied.

Takeaway: Policyholders need to be aware of the limitations of "advertising injury" coverage, which many policies define narrowly. Further, while exclusions applicable to patent infringement and products that do not conform with their advertising are common, some policies, like Vitamin Health's, also contain exclusionary language that an insurer might use to bar otherwise covered advertising injury claims whenever they include an allegation of intellectual property infringement. Insureds should consider whether that language can be eliminated from their policies.

But Insurers Resist Coverage Under Product Recall/Contamination Policies

Definitions of Accidental Contamination and Governmental Recall can be Outcome-Determinative for Coverage Under a Product Recall/Contamination Policy

In a recent case that highlights the outcome-determinative differences in the language of newer

"product contamination" policies, a poultry manufacturer successfully claimed coverage for losses suffered when it destroyed millions of pounds of chicken. Foster Poultry Farms Inc. v. Certain Underwriters at Lloyd's, London, No. 1:14-cv-953 (E.D. Cal. Jan. 20, 2016). The U.S. Department of Agriculture's Food Safety and Inspection Service (FSIS) had not approved the product for sale because of poor pest control and sanitation provisions at the plant, including the presence of salmonella. The insured sought coverage for those losses from Lloyd's.

Lloyd's denied the claim on the ground that there was no showing of actual contamination sufficient to trigger the "accidental contamination" coverage under the policy and no recall of previously distributed product from customers sufficient to trigger the coverage for a "governmental recall." The court rejected both arguments.

The key to these findings was the definitions of accidental contamination and governmental recall. "Accidental contamination" was defined as "an 'error' in the production, processing or preparation of any insured products 'provided that' their use or consumption 'has led to or would lead to bodily injury, sickness, disease or death.'" Slip. op. at 9. The court rejected the insurer's contention that the insured needed "conclusive evidence" that the products would have caused harm, noting that it would not interpret the policy to require the insured to market the products to see whether people got sick from consuming them. Under this policy language, it was sufficient that FSIS had concluded the product could not be sold because it was not safe to eat. Slip. op at 11-12.

The court also rejected the insurer's contention that the destruction of the product before it had been sold to third parties was not a government recall. The court noted that the policy did not define the term "recall" and that it defined governmental recall to include a voluntary or compulsory recall of insured products arising directly from a regulatory body's determination that there is a reasonable probability that insured products will cause "serious adverse health consequences or death." Slip op. at 16. The court noted that the insurers had not limited the recall to products that had left the insured's possession.

Takeaway: The Foster court distinguished cases reaching different results under similar fact patterns based on other definitions of the triggering events. Some "product recall/contamination" policy forms require the insured to demonstrate "actual" rather than "suspected" contamination to trigger coverage for contamination losses. These language differences should be considered by an insured placing or renewing this type of coverage.

Another Takeaway: Insureds should be attentive to the application process for product recall and other specialty policies. Such policies often require detailed applications. When the insured presents a claim, the insurer will look for an omission or inaccuracy in the application that it can use to deny coverage for the claim or rescind the policy.

Between a Rock and a Hard Place

The cases described above illustrate the challenges food manufacturers and supplement makers face in ensuring they are covered for risks associated with common types of claims. On the one hand, manufacturers might not be able to rely on courts to uphold the language of their general liability insurance policies, which are supposed to protect them against claims that their product has damaged a third party's product. On the other hand, even when manufacturers purchase specialty policies expressly to afford such coverage, insurers may interpret them narrowly or seek to rescind them altogether.

Food and supplement manufacturers will continue to face battles in securing coverage for product contamination and recall claims. They can help make this process easier by working to tailor their insurance coverage when they place or renew it.

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