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Think Your Insurance Will Cover Your Recall? Think Again

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Last month, Aspen Hills, a supplier of cookie dough implicated in the nationwide recalls of Blue Bell and other ice creams, announced it was ceasing production altogether.[1] This is just one example of the impacts of product contamination and recalls throughout the supply chain. Food and supplement manufacturers are keenly attuned to the need to prevent such contamination, for example by requiring pathogen testing at the supplier level. But they also should know when their insurance policies will — and will not — respond to such events.

In recent years, the insurance industry has marketed "product recall" or "product contamination" insurance. (We refer to them here as "product contamination" policies.) This is a "specialty" insurance product that provides some coverage for the gaps created by product recall and other "business risk" exclusions in standard general/products liability policies.

If you are a supplier to a food company and you inadvertently provide the wrong ingredient to your customer, you might expect your insurance to provide coverage for that liability. Similarly if you are a customer who receives the incorrect ingredient from a supplier and you have to recall the finished product because it is mislabeled, you might expect either your products liability or your product contamination coverage to respond. In both cases, you might be wrong. As we explain, cases involving "faulty" or "wrong" ingredients can trigger recalls (and related losses for companies and their suppliers) but often are not covered by either products liability or product contamination policies.

Products Liability Policies Exclude Recall Losses

Four exclusions found in the standard products liability policies are collectively termed the "business risk" exclusions. These exclusions bar coverage for damage to the insured's own product or property, the insured's own work and "impaired property" (property that is not physically injured but is less useful because it incorporates the insured's defective product). Such policies also include "product recall" exclusions.[2] According to many courts and commentators, business risk exclusions exist to "reinforce the principle that liability policies do not insure against the simple cost of poor performance."[3]

The product recall exclusion has been the subject of myriad litigations, with mixed results. For example, the exclusion was held to bar coverage where the recall involved the insured's own products and encompassed a wide variety of products without regard to whether the "sister" products were actually contaminated.[4] But policyholders have successfully obtained coverage when the recall was not of the policyholder's own product, work or impaired property,[5] and when the recall was limited to just those

products known to be defective rather than a market-wide recall of all "sister" products.[6]

Product contamination policies don't necessarily fill the coverage gaps created by these exclusions.

Contamination Policies

Contamination policies often do not respond unless contamination, or another event, has resulted or would result in bodily injury.

Although many contamination policies provide coverage when contamination has resulted or could result in either bodily injury or property damage,[7] some insurers limit their coverage to recalls triggered by events that have resulted or could result in bodily injury. For example, Chubb's "Recall and Crisis Management Insurance" form, marketed to the life sciences industry, provides coverage for expenses arising out of a "Class 1 Recall," but such a recall is limited to "a situation in which there is a reasonable probability that the use of, or exposure to, such product will cause serious adverse health consequences or death."[8] This definition is consistent with U.S. Food and Drug Administration's definition of a Class 1 recall. See 21 C.F.R. §7.3 ("Class 1 is a situation in which there is a reasonable probability that the use of, or exposure to, a violative product will cause serious adverse health consequences or death.").

Windsor Food Quality Company Ltd. v. Underwriters of Lloyds of London, 234 Cal.App.4th 1178, 1186 (2015), illustrates this limitation on the scope of a contamination policy. In Windsor Foods, the insured made burrito products with ground beef supplied by a "downer" cow slaughterhouse that refused inspection. The products could not be marketed because the meat used in the finished product had not passed U.S. Department of Agriculture inspection. Windsor Foods sought coverage under its product contamination policy, and lost. The court found there was no coverage because, although the ingredient had been banned, it had not been proved to be harmful. Id. at 1187. In other words, because Windsor Foods could not show that its products were actually contaminated or that they had made consumers sick, the contamination policy did not cover its losses.

Not All Property Damage is "Property Damage" to Insurers

Coverage for "faulty ingredient" losses also is limited because not all property damage is covered "property damage" for insurance purposes. Several cases illustrate this point.

The first case involved a "mad cow" ban on Canadian beef that was imposed in 2003. A U.S. oil and shortening manufacturer who used solely Canadian beef sought coverage under its business interruption insurance for losses caused by the stoppage of its business. The policyholder argued that its inability to sell its beef tallow product was due to the U.S. government's conclusion, inherent in the ban, that Canadian beef from "mad cows" was damaged, thus satisfying the policy's requirement of "property damage" that caused the business interruption. A federal appeals court disagreed, however, holding that the loss was caused solely by the embargo, not by any known physical damage to the beef, and so it was not covered.[9]

Other "faulty ingredient" cases turn on whether the damaged product is the insured's product or a third party's product, which is covered. Under standard general liability policies, damage to the insured's product itself is excluded. Similarly, under product contamination policies, coverage is often limited to events involving "physical damage to, destruction of or loss of use of property other than the insured product."[10] If the insured is an ingredient supplier, it is possible that neither its general liability nor its

product contamination policy will apply unless its ingredient damaged its customer's downstream product.[11]

In Atlantic Mutual Insurance Co. v. Hillside Bottling Co. Inc., 903 A.2d 513, 519-20 (N.J. Super. Ct. App. Div. 2006), the court held there was no coverage under the bottler's general liability policy for soft drinks contaminated with ammonia by the bottler's faulty manufacturing process. The court held that the customer's recall was caused by the bottler's own work and own product, which were excluded under the policy. Although the finished product was indeed contaminated, the court held the loss was an economic loss arising out of a breach of contract or warranty rather than "property damage" to a third party. In contrast, when a policyholder sold adulterated fruit juice ingredients that a customer incorporated into its finished juice product, the policyholder was successful in obtaining coverage under its general liability policy for "property damage" to the customer's product.[12]

Under at least one court's view, even if a supplier's faulty ingredient indisputably damages the finished product, such damage might not be covered if the product, including all its ingredients, has become an "integrated system." Last year a 3-2 majority of the Wisconsin Supreme Court held that a defective probiotic ingredient did not cause "property damage" to a dietary supplement pill once all the ingredients were blended together.[13] Rather, the majority found, because the supplement pill became an "integrated system," damage to the system meant "damage to the product itself, not damage to other property."[14] The court held that the supplier's general liability insurance did not cover this damage to the customer's finished product. Further discussion of the Wisconsin Pharmacal decision is available here.

In Windsor Foods, the policyholder was the recipient of allegedly contaminated ingredients. Windsor's product contamination policy limited coverage to the insured's product "including their ingredients and components once incorporated therein …" and not before. Interpreting this language, the court held that the policy would cover contamination of the finished product that happened during or after its preparation by the policyholder; the court said the policy did not cover damage that results from incorporation of an ingredient that was contaminated before it was incorporated into the finished product.

Policyholder Beware

These cases show that, even when policyholders carry both general liability and specialty contamination or recall policies, coverage for damages caused by faulty ingredients might be uncertain. Recalls are intended to prevent harm and remove from the stream of commerce products that do not comply with government regulations. Recall exclusions are broadly drafted with the intent to exclude those events. "Product contamination" policies are often more narrowly drawn; they may cover the costs of a recall if that recall was triggered by an event that would likely lead to bodily injury or by actual contamination of a customer's product.

In practice, the threshold for obtaining coverage under these contamination policies is higher than the threshold for conducting a recall. If a policyholder purchases a recall or contamination policy to minimize its risk of faulty ingredient claims, it should bear in mind that contamination policies are not always as standardized as many general liability policies, and some terms can and should be tailored to fit the policyholder's business.

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[1] K. Samuelson, "Supplier Connected to Blue Bell Ice Cream's Listeria Scare Has Shut Down," Fortune, Feb. 7, 2017.

[2] CG 00 01 12 07, exclusions k, l, m, n.

[3] Peter J. Kalis, Thomas M. Reiter, & James R. Segerdahl, Policyholder's Guide to the Law of Insurance Coverage § 10.02 (a) (2000 Supplement).See also Weedo v. Stone-E-Brick Inc., 405 A.2d 788, 791 (N.J. 1979). The most recent iteration of the recall exclusion applies to:

Damages claimed for any loss, cost or expense incurred by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of:

(1) "Your product";

(2) "Your work";

(3) "Impaired property";

if such product, work or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or dangerous condition in it.

CG 00 01 12 07, exclusion n.

[4] See Hillside Bottling, 903 A.2d at 522.

[5] See, e.g., Amerisure Mut. Co. v. Hall Steel Co., 2009 Mich. App. LEXIS 2545, *16-17 (Mich. App. Ct. Aug. 27, 2008) (recalled windshield wiper brackets were not "impaired property" because they could not be restored to use by removal of the insured supplier's steel); Am. & Foreign Ins. v. Northwest Castings Inc., 2000 U.S. Dist. LEXIS 20662, *10 (W.D. Wash. Sept. 13, 2000) (recalled trailer hitches were not "impaired property" because they could not be restored to use by removal of the insured's defective castings).

[6] Travelers Indemnity Co. v Dammann, 2008 U.S. Dist. LEXIS 9759, *21 (D.N.J. Feb. 11, 2008) (allowing coverage for damages caused by supplier's mercury-contaminated vanilla beans where supplier only recalled the actually contaminated batch of beans).

[7] See, e.g., ACE "Recall Plus" policy form REC-7519 (01/13).

[8] See Chubb Product Withdrawal and Crisis Management Insurance Form 80-02-6427 (Ed. 8-04).

[9] Source Food Technology Inc. v. U.S. Fidelity & Guaranty Co., 465 F.3d 834, 838 (8th Cir. 2006).

[10] See, e.g., ACE “Recall Plus Insurance for Consumer Goods” policy form REC-7521 (01/13).

[11] Some policies include “loss of use” in the definition of property damage, while others do not. Compare, e.g., ACE “Recall Plus Insurance for Consumer Goods” policy form REC-7521 (01/13) with Crum & Forster “Recall Protect” Product Recall Insurance for Consumable Products, RPCP-Wording 09.14.

[12] Zurich American Ins. Co. v. Cutrale Citrus Juices USA Inc., No. 00-CV-149, 2002 U.S. Dist. LEXIS 26829, *11 (M.D. Fla. Feb. 8, 2002) (damage was property damage, not mere economic loss, even though measure of damages was reduction in sale price of finished product).

[13] Wisconsin Pharmacal Company LLC v. Nebraska Cultures of California Inc., 2016 WI 14 (March 1, 2016).

[14] Slip op. at ¶27-28, 34.
