

A Food Recall Strikes — Are You Ready?

By Robyn L. Anderson

The U.S. Food and Drug Administration (FDA) averages about 250 food recalls each year. This daunting statistic leaves many in the food industry with the uncomfortable fear that a recall is a matter of “when,” not “if.” While it is of utmost importance to use procedural and contractual safeguards to mitigate and avoid such risk, it is also prudent to understand when a recall may trigger coverage under one or more of your insurance policies. This article highlights the insurance avenues, options and obstacles that may arise if you find yourself facing a food recall due to suspected or known food contamination.

What to Look for in Product Recall Insurance

At the risk of oversimplification, the insurance world is traditionally divided into two types of coverage: (1) “First-party” property coverage, which insures against risk of physical loss to your own property, and (2) “third-party” liability coverage, which insures against the risk of liability to others if you accidentally injure a third party, or damage that party’s property. In the recall context, an insured might find that it has both physical loss to its own property, as well as potential liability to others. Modern product recall policies take into account the hybrid nature of these claims and are often written to provide both “recall expense” and “recall liability” coverage in one package, with a single limit to cover both types of claims.

For example, a recall policy may be written to cover recall notification costs, public relations/crisis management control, product buy-back costs, handling charges, disposal costs, extra labor costs or costs to rent additional storage space if needed. At the same time, the policy may also reimburse the insured for defense costs and settlements or judgments if customers or other third parties sue the insured due to their own economic expenses following the recall. There are different protections offered by food contamination and food recall policies, so both options should be explored to figure which works best for you.

If procuring recall coverage, it is important to place coverage with sufficient policy limits to provide meaningful protection for your company. Typically, it is the stand-alone recall policy that provides the more significant policy limits, as opposed to the sometimes-modest sub-limits that are offered as an endorsement to existing coverage. It is equally important to negotiate the specific terms of a recall policy. There is more flexibility built into these products because there is not an industry-standard recall policy. Insurers are writing policies according to their own design, and they are more open to tailored policy terms. If you’re spending significant premium dollars, you want to make sure the policy wording matches the risk that you actually face based on the place you hold in the distribution chain and the product or work that you’re providing.

In a world of recalls based on suspected, possible and unconfirmed contamination, it is important to make sure that the recall policy will be triggered under this most probable scenario. Thus, coverage should be triggered even if it is a “voluntary” recall—which, in reality, isn’t so voluntary—and even if there is no proof of “actual” contamination. Further, adding in language that covers liability for the “impairment” of other property is useful, to avoid coverage doubts on the recall liability coverage.

Finally, it is important to keep in mind that product recall insurance is a supplement to, and does not replace, traditional liability and property coverage. It will exclude liability coverage for bodily injury and property damage liability in an effort to avoid unintended overlap with the policyholder’s general liability coverage. Thus, if a lawsuit alleges bodily injury or third-party property damage that arose from a recalled product, you would still need to look at your regular “general liability” policy, which insures against liability for “bodily injury” and “property damage.” Of course, the lawsuit may be worded in such a way that it requires both insurers to step in and share in the defense of the lawsuit, albeit

for different coverage reasons. The following discussion highlights the coverage issues that commonly arise under the standard general liability policy when the liability claim stems from a recall.

General Liability Coverage for Recall-related Bodily Injury Claims

If a food recall does lead to actual or alleged bodily injury and litigation ensues, defense of the claim should be tendered to your general liability insurer. Although general liability policies typically have a "Recall of Products" exclusion, that exclusion should not be interpreted to apply to third-party bodily injury claims. This summer we saw Cargill's liability insurer file a lawsuit against one of Cargill's upstream suppliers after the insurer had settled, on behalf of Cargill, numerous third-party bodily injury claims that had been filed following a 2007 *Escherichia coli* beef recall. Cargill was able to tap into its general liability coverage because the claims had bodily injury allegations, rendering the product recall exclusion a moot issue.

Which is not to say that insurers won't try to raise other coverage defenses. For example, Plainview Milk Products Cooperative, a Minnesota dairy cooperative, found itself defending a declaratory judgment action filed by its own insurer after it issued a 2009 recall for potentially *Salmonella*-contaminated milk powder. In the lawsuit, Plainview discovered that its insurer was leading its coverage defenses with the policy's pollution exclusion, rather than the recall exclusion. Most policies define "pollutants" to include "contaminants," so the insurer argued the salmonella contamination brought the claim outside of the scope of coverage. Yet, many courts reject the idea that a pollution exclusion should be applied to cases that do not involve traditional, industrial environmental pollution and remediation. In Plainview's case, the issue was left undecided. Despite the insurer's adamant coverage defenses, it still publicly offered \$4.5 million to settle the insurance dispute, which was sufficient to dispose of the coverage case without a court ruling.

Many general liability policies also

contain "bacteria" exclusions, but this exclusion should not pose a threat to those in the food industry because the typical exclusion makes an exception for bacteria that is on or in a product intended for bodily consumption. (Note: The same exclusion in first-party property policies does not have the same carve out, so those in the food industry should look to see what impact the bacteria endorsement might have on their first-party property claims).

General Liability Coverage for Recall-related Property Damage

A more heavily litigated question, perhaps, is whether a general liability policy covers, or should be interpreted to cover, third-party property damage claims stemming from a recall, despite the "Recall of Products" exclusion. Here is how the exclusion is typically worded:

This insurance does not apply 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...your product...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.

Although the exclusion is broadly worded, various courts have found ways to avoid its application. For example, when a recalled product is integrated into an end product such that the end product cannot be repaired at a cost that is below the cost to replace, several courts recognize that this is third-party property damage to the end product and the insurer must defend the claims despite the recall exclusion.

This result is not universal, though, and the cases are fact intensive. In one case from 2005, the Seventh Circuit Court of Appeals applied Illinois law and held there was no coverage for a manufacturer who recalled its peanut butter packets that had been placed in its customers' cookie mix boxes. The court reasoned that the contaminated peanut butter was self-contained in its own

package and that it never touched the dry powder pouch that was also in the cookie mix box. Thus, in the court's mind, there was no physical damage to the customers' other property. And, even if there had been, the court reasoned, the types of damages claimed by the downstream customer in that lawsuit would have been barred by the product recall exclusion.

You also see a handful of courts refusing to apply the recall exclusion if the insured, itself, did not initiate the recall. This approach may find its roots in the insurers' "moral hazard" argument, which assumes that policyholders may be too quick to issue a recall if they do not have to pay the associated costs—an assumption that seems to be unfounded given the reputational damage, enormous distraction and other intangible costs of a recall. Applying the exclusion to the insured's own recalls would address this concern; applying it to an upstream suppliers' recall would not. Thus, in protecting the reasonable expectation of the policyholder, several courts have held the exclusion is inapplicable if the insured was a victim of the recall just as much as its own customers.

Conclusion

Recalls raise a variety of insurance coverage questions and issues, and courts have not always helped matters by deciding the same coverage issues in different ways in different jurisdictions. Proactively pursuing recall coverage with meaningful policy terms and limits may help avoid coverage problems down the road. Then "when"—not "if"—a recall strikes, promptly look at all of your existing coverage to see what policy—or policies—may respond.

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Robyn handles a broad range of coverage claims representing both policyholders and insurers, but she has particular expertise with matters concerning product recalls, food contamination, environmental liability, toxic tort liability, product defect, business interruption and the London insurance market.