Insurance for Food Contamination and Recall Events

By Brian J. Osias and Michael Collins Smith – November 2, 2015

American businesses face increased exposure to liability for food contamination and recall events. In 2010, Congress passed the Food Safety and Modernization Act (FSMA), “aim[ing] to ensure the U.S. food supply is safe by shifting the focus from responding to contamination to preventing it.” When enacted in 2011, the FSMA granted for the first time the Food and Drug Administration (FDA) enforcement power over its recall actions. Under the FSMA, the FDA no longer must seek an injunction to compel a manufacturer to recall a product. The FDA is now empowered to issue mandatory recalls enforced by strict monetary sanctions.

Although the FDA does not issue aggregate data on the number of recalls issued pre- and post-enactment of the FSMA (and data on the number of units recalled would be more informative in any event), even a quick look at the FDA’s website demonstrates the volume of recall actions—over 230 in the first six months of 2015.[3] Some recalls are enormous. In 2014, for example, Kraft recalled 1.2 million cases of cottage cheese due to the potential for illness.[4]

As a result of the FSMA and the current regulatory climate, businesses in all phases of food production, preparation, distribution, and sale face the constant threat of a potentially debilitating recall event. Such businesses have sought to insure themselves against recall losses and, when faced with liability, have sought coverage under their policies. Insurers, however, have often denied coverage for recall losses under both comprehensive general liability (CGL) policies and first-party property insurance policies, and courts have in many, perhaps most, instances upheld those determinations. A number of insurers, consequently, began offering specialized food contamination policies, which purportedly provide expanded coverage for recall events. This article examines potential impediments to coverage for food recall events under CGL and property policies and the typical structure and coverage provided by specialized policies, and explains the importance for policyholders of carefully scrutinizing policy language at the time of purchase and sale under the specialized policies because even subtle language distinctions may prove significant.

Coverage under Standard CGL and Property Policies

Most businesses maintain CGL and property insurance as standard practice. Although policyholders have secured coverage for food recall events under such policies, and the importance of looking to those policies cannot be minimized, it has often been an uphill battle continually made more difficult through the introduction of additional exclusions over time by the insurance industry.

Coverage under third-party liability policies. CGL policies by nature insure against third-party liability, expenses imposed by lawsuits, or government action. CGL policies generally cover liability imposed “because of” “bodily injury” or
“property damage” or both. As CGL policies do not cover first-party loss sustained by the policyholder, the cost of recalling a policyholder’s own products are inherently beyond the scope of CGL coverage. Where a policyholder faces a lawsuit for injury caused by the company’s allegedly contaminated food, however, the CGL policy would appear to respond to the loss. Nevertheless, policyholders face numerous challenges in securing coverage even when faced with direct liability for a food contamination or recall event.

As a preliminary matter, the policyholder must establish either bodily injury or property damage. Where physical sickness has manifested itself, the presence of covered bodily injury is relatively clear.[5] In many cases, however, intervening events preclude actual physical contamination (indeed, the primary goal of the FSMA). Extensive litigation has considered whether lawsuits alleging contamination or potential contamination incorporate the property damage necessary to trigger coverage under a CGL policy.

CGL policies expressly exclude coverage of the insured’s own product. The “your product” exclusion—and its relatives, the “your work” and “impaired property” exclusions—are “intended to exclude coverage for damage to the insured’s product, but not for damage caused by the insured’s product to persons or property other than the insured’s own product.”[6] Some courts have read the exclusion expansively. In Tradin Organics USA, Inc. v. Maryland Casualty Co.,[7] for example, the Second Circuit affirmed the lower court’s ruling concerning the “your product” exclusion, finding coverage barred although the insured’s supplier sent the contaminated product directly to the customer, bypassing the insured entirely.

Where a policyholder’s contaminated products are incorporated into another product, however, courts generally find the existence of property damage.[8] In that circumstance, the most crucial issue may be the extent of covered damages. In National Union Fire Insurance Co. of Pittsburgh, PA v. Ready Pac Foods, Inc.,[9] for example, the policyholder supplied lettuce contaminated with E. coli to numerous Taco Bell restaurants. While the sickened patrons alleged covered bodily injury, and Taco Bell alleged covered property damage to its products, the court considered the narrow issue of whether Taco Bell’s loss of business due to closure following the outbreak constituted loss “because of” property damage. The court narrowly read the policy and held in the negative:

Taco Bell’s claim for lost profits does not amount to “an essential expense incurred in the performance of the work” to remedy either the damage done to tangible property at Taco Bell restaurants or the personal injuries suffered by Taco Bell’s customers. Taco Bell’s claim for lost profits is not a measure of the damage to meals served at Taco Bell restaurants nor the cost of the destroyed contaminated food items. Taco Bell’s alleged lost profits as a result of customers deciding not to eat at Taco Bell restaurants nationwide is not a measure of the value of the meals and food that were destroyed at Taco Bell restaurants directly affected by the Outbreak. Furthermore, Taco Bell’s claim for lost profits from
the decline in patronage is also not a measure of the costs incurred to clean up the Taco Bell restaurants affected by the Outbreak.[10]

Therefore, the policyholder could not rely on its CGL policy to cover liability it incurred to Taco Bell for Taco Bell’s claims of lost profit.

Also acting as a bar to coverage is the so-called “sistership” or, more modernly, “recall” exclusion. The most recent version of the Insurance Services Office (ISO) exclusion excludes the following:

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”; or
(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.[11]

Although derived from the aircraft industry, where a major accident with one type of plane would prompt the recall of every other plane of that make (its “sisterships”),[12] the exclusion has grown to exclude nearly all direct expenses arising from recall.[13] Specifically, under previous versions of the exclusion, courts sometimes held that it did not bar coverage where a third party instituted the recall (as opposed to the policyholder). The new exclusion clarifies that issue by excluding “loss, cost or expense incurred by you or others” because of recalls.[14]

**Coverage under first-party property policies.** Theoretically, policyholders’ first-party property policies would fill in the gap left by CGL policies’ “business risk” exclusions.[15] Indeed, property insurance policies are intended to cover loss to the policyholder’s own property, as in the case of a fire or flood insurance policy. Generally speaking, property policies respond where the policyholder can prove “direct physical loss or damage” to its property.

Some courts have held that a property policy’s requirement for physical loss precludes coverage for preventive recalls where the existence of damage is speculative.[16] Another issue may arise where a contamination event affects certain identified products, and other potentially affected products are also recalled or destroyed.[17]

Regardless, in many cases, coverage under property policies is excluded by the “contamination” exclusion. For example, in *HoneyBaked Foods, Inc. v. Affiliated FM Insurance Co.*, the exclusion at issue provided “[t]his policy does not insure against loss or damages caused by [contamination including pollution]; however, if
direct physical loss or damage insured by this policy results, then that resulting direct physical loss or damage is covered.”[18] The policyholder discovered during a routine inspection the presence of Listeria bacteria, which was determined to have grown in an unclean hollow roller. Because the policy defined “pollution” to include bacteria, the court found the loss to be excluded from coverage.[19]

In contrast, in Allianz Insurance Co. v. RJR Nabisco Holdings Corp.[20] the policy excluded “‘[l]oss or damage caused by or resulting from contamination unless such loss or damage results from a peril not otherwise excluded . . . .’”[21] Nabisco received numerous customer complaints stemming from a faulty chemical sealant in a third-party warehouse. While acknowledging the exclusion’s “somewhat awkward wording,” the court nevertheless held that “[t]he actions of a third party . . . are classic ‘perils’ covered by an ‘all risks’ policy” and that the exclusion did not bar Nabisco’s loss.[22]

Accordingly, policyholders may find themselves unprotected from food contamination and recall loss despite a seemingly strong insurance portfolio. Insurers now offer specialized insurance products purportedly aimed at recalls, but aggressive interpretation of those policies by insurers and courts has, at times, been disappointing.

**Food Contamination Policies**

Food contamination policies have become increasingly prevalent. According to Aon, a prominent insurance broker, as of 2014 approximately 30 insurers offered some form of contamination/recall coverage.[23]

It is important to note that food contamination policies are generally written on a “manuscript” basis, that is, unique to each insurer and amendable at the request of the prospective policyholder for an increased premium. CGL and property insurance policies, in contrast, are generally composed of standardized forms promulgated by the ISO, although some of those policies are manuscripted in whole or in part as well.[24] A wide variety of coverages are therefore available, tailored to the needs of individual policyholders. The corollary is the potential for crucial gaps in coverage for unwary, uninformed, or inadequately advised businesses. The need to carefully examine the language of these policies cannot be overstated.

While sometimes termed “recall insurance,” food contamination policies generally do not provide coverage in the absence of bodily injury or at least a real possibility of bodily injury. A recent Eighth Circuit decision opined that the history of the FSMA brings into focus why insurers and food industry insureds would agree to limit Accidental Product Contamination coverage to recall incidents in which consumption of the contaminated or mislabeled product “resulted, or may likely result” in physical symptoms of bodily injury, sickness or disease or death of any person. As other courts to consider this coverage have concluded, this “is not a
recall insurance policy.” Covering voluntary recalls that have no direct relation to public health hazards would increase the cost of the insurance, extending coverage to voluntary actions that should remain part of an insured’s cost of doing business.[25]

Notwithstanding the court’s arguably flawed logic, the fact remains that the most basic food contamination policies do not cover a large number of recall events.[26] Savvy policyholders may nevertheless define their own coverage, balancing cost and risk, to acquire the correct food contamination policy for their business.

The core coverages in a food contamination policy include lost profits, business interruption, recall expenses, investigative costs, and rehabilitation expenses. Over time, the core terms of most food contamination policies have become more similar, although, as noted above, they are not nearly as standardized as CGL or property policies. The insuring agreement typically covers “Insured Events,” defined in a current Catlin offering as follows:

Any inadvertent or unintentional contamination, impairment or mislabeling of an Insured Product(s), which occurs during or as a result of its production, preparation, manufacture, packaging or distribution; provided that the use or consumption of such Insured Product:

(i) has resulted in or would result in clearly identifiable internal or external symptoms of bodily injury, sickness, disease or death of any person(s), within three hundred sixty five (365) days following such consumption or use or

(ii) has caused or would cause Property Damage to or destruction of tangible property other than damage to or destruction of Insured Product(s) or any other tangible property or product in which the Insured Product(s) is incorporated as an ingredient or component.[27]

Again, slight differences in the insuring agreement’s terms could prove determinative as to coverage.

Many policyholders have successfully secured coverage under their food contamination policies (or at least avoided their insurers’ motions for summary judgment in cases challenging claim denials). In Hot Stuff Foods, for example, the policyholder sent sausage containing monosodium glutamate (MSG) to a facility intended to distribute only MSG-free products.[28] After informing the FDA of its error, the policyholder voluntarily recalled 193,507 cases of mislabeled sausage.[29] Despite the recall, some 40,000 cases remained in commerce. The policy at issue covered, inter alia, “mislabeling,” “provided always that the consumption or use of the Named Insured’s CONTAMINATED PRODUCT(S) has, within 120 days of such consumption or use, either resulted, or may likely result in” bodily injury.[30] The district court found the policy’s juxtaposition of the words
“may” and “likely,” with respect to the likelihood of bodily injury, to create an ambiguity that it construed in favor of the policyholder.[31]

While the Eighth Circuit disagreed with the trial court’s analysis, it nevertheless affirmed the denial of summary judgment in favor of the insurer. In the appellate court’s view “the parties to this insurance contract fixed where in the range of product contamination risks coverage should end by choosing a term requiring more than a possibility of physical injury (‘may’), but less than a probability (‘likely’).”[32] Thus, the issue was whether the consumption of MSG “may likely lead” to physical injury. Given that even the insurer’s expert conceded that MSG might be the cause of hives or swelling, albeit in “very rare subjects,” the court found a question as to material fact that precluded the grant of summary judgment. Although “some 150,000 cases of the slightly tainted products were consumed with no reported adverse health results,” the court noted that “three prospective jurors testified they carefully avoid foods containing MSG because of their personal experience with allergic reactions and headaches.”[33]

The recent California appellate decision in Windsor Food Quality Co., Ltd. v. The Underwriters of Lloyds of London,[34] on the other hand, demonstrates the pitfalls that policyholders can encounter in seeking coverage under their contamination policies. There, the policyholder incorporated beef supplied by a third party into its burritos. When the U.S. Department of Agriculture issued a class II voluntary recall of the third-party beef, the policyholder recalled its product and sought coverage under its contamination products insurance policy. Specifically, the beef supplier had improperly used “non-ambulatory disabled cattle” (“downer cows”) for its products. Among the contamination risks was mad cow disease.[35]

The policy provided coverage for “insured events” including “accidental product contamination” and “malicious product tampering.”[36] Crucially to the court’s decision, the policy defined “insured products” as “all products including their ingredients and components once incorporated therein of the Insured that are in production or have been manufactured, packaged or distributed by or to the order of the Insured . . . .”[37] “Accidental product contamination” under the policy required that the contamination “would lead to or has led to bodily injury, sickness, or disease of any person, animal or livestock physically manifesting itself within 120 days of its consumption or use.”[38] Expert testimony demonstrated that the incubation period for mad cow disease is “at least 10 years.”[39] Thus, the policy did not respond to the loss by virtue of its “accidental product contamination” coverage provision.

Although questioning whether the policyholder presented evidence of “malicious product tampering” (employees at the supplier had mistreated animals at the slaughterhouse), the court determined that coverage was precluded in any event because the beef did not constitute an “insured product” under the policy. The court summarized the policy’s “insured product” definition as requiring “contamination or tampering with its product during or after manufacture, not before [the policyholder] began the process.”[40] Accordingly, “[i]n order for a frozen burrito to qualify as an
insured product, there must have been contamination or tampering during production, manufacture, packaging, or distribution — not because one of its ingredients supplied by a third party was adulterated.”[41]

Likewise, in *Fresh Express Inc. v. Beazley Syndicate 2623/623 at Lloyd’s,*[42] a California appellate court found that the policy at issue did not cover an *E. coli* outbreak that was not a result of the policyholder’s own negligence. Following a trial decision for $12 million in favor of the policyholder, the insurer appealed, arguing primarily that the trial court erred “because all of the losses established by [the policyholder] at trial were attributed to the ‘E. coli outbreak,’ an event that was not covered by the policy, rather than to ‘Accidental Contamination,’ the only event that was covered by the policy.”[43] The appellate court agreed. The policy covered “[e]rror by [the policyholder] in the manufacture, production, processing, preparation, [or] assembly . . . of any Insured Products . . . which causes [the policyholder] to have reasonable cause to believe that the use or consumption of such Insured Products has led or would lead to” bodily injury.[44] The court held that “[w]hile ‘the E. coli outbreak’ itself may have given policyholder cause to believe that its products were contaminated, ‘the E. coli outbreak’ was not an ‘[e]rror by [the policyholder]’ so it could not qualify as ‘Accidental Contamination’ and thereby an ‘Insured Event’ under the policy.”[45]

In another case under a food contamination policy, *Caudill Seed & Warehouse Co., Inc. v. Houston Casualty Co.*,[46] the policyholder sought coverage for two recall incidents. The policy there covered contamination in the policyholder’s production process, or fault in “design specification or performance” of the insured’s product that lead to bodily injury.[47] Notably, the policy also covered “publicity” implying contamination, without necessity of bodily injury. One of the policyholder’s products, peanuts, was determined by the FDA to be tainted with salmonella, and a mandatory recall was initiated. After the insurer denied coverage, the policyholder brought suit in the Western District of Kentucky. The policyholder was also forced to recall alfalfa seeds after a separate salmonella outbreak.

As to the peanuts, the court found no coverage. “While [the policyholder] was . . . directed by the FDA to recall its own products, the source of the contamination or impairment did not occur at [the policyholder’s] facilities.”[48] Rather, “[t]he peanuts were contaminated or impaired prior to [the policyholder] obtaining them.”[49] Because the FDA did not identify policyholder as the source of the outbreak, the policy’s provision related to publicity of contamination failed to save coverage. As to the alfalfa seeds, however, “publicity . . . cited [the policyholder] as the source of the Salmonella outbreak.”[50] The alfalfa seed recall therefore triggered the policy’s coverage provision, and the dispute was relegated to the amount of the policyholder’s covered damages.

These few decisions demonstrate potential pitfalls facing policyholders in obtaining adequate coverage for contamination and recall events even when specialized insurance is purchased. The policyholders in *Windsor Food, Fresh Express,*
and *Caudill Seed* acquired insurance specifically to cover recall losses, and yet, when faced with contamination events that threatened mad cow disease, *E. coli*, and salmonella, respectively, they were left largely unprotected.

**Procuring Adequate Coverage**

As discussed, food contamination policies differ substantially from insurer to insurer and are largely customizable at the request of the prospective policyholder. The standard policy offered by Liberty, for example, covers “accidental contamination” where ingestion of the insured product “has resulted in or would result in bodily injury . . . within 365 days . . . .”[51] This coverage differs, perhaps determinatively, with the policy at issue in *Windsor Foods*, which covered only contamination resulting in injury within 120 days of ingestion. Prospective food contamination policyholders are encouraged to procure and compare different insurers’ policy forms prior to purchasing coverage.

Beyond the differences in insurers’ basic forms, policyholders may purchase endorsements that presumably expand coverage for certain losses. ACE Group, for instance, advertises the following add-ons to coverage:

- Customer Extra Expense Endorsement
- Customer Loss of Gross Profit Endorsement
- Customer Rehabilitation Expense Endorsement
- Defense Cost Endorsement
- Extortion Costs Endorsement
- Extra Expense Endorsement
- Governmental Recall Endorsement
- Long Term Agreement Endorsement
- Loss of Gross Profits Endorsement
- Rehabilitation Expenses Endorsement
- Replacement Costs Endorsement
- 15 Month Claim Period Endorsement
- 18 Month Claim Period Endorsement
- Adverse Publicity Coverage Endorsement[52]

The available endorsements demonstrate, for one thing, that important coverages may be sorely lacking from an insurer’s basic policy. Note, for instance, ACE’s available endorsement for “Governmental Recall,” which adds governmental recall to the policy’s definition of “insured event.” Many policyholders, seeing that “recall expense” is generally a covered form of loss, would assume coverage for FDA recalls without the benefit of an additional endorsement. As the policyholder in *Fresh Express* learned, however, many recalls are not insured events in the first instance, and a policy’s coverage of recall expenses is of no avail absent a triggering insured event. As the policyholder in *Fresh Express* learned, however, many recalls are not insured events in the first instance, and a policy’s coverage of recall expenses is of no avail absent a triggering insured event. Likewise, in *Caudill Seed*,[53] the provisions granting coverage in the event of negative publicity, even in the absence of an otherwise covered contamination event, can work powerfully in the policyholder’s favor. While coverage for losses from publicity of contamination were apparently covered in
the Caudill Seed core policy language, “Adverse Publicity Coverage” must be negotiated and purchased as a separate endorsement from ACE Group.

Businesses wishing to insure against food contamination and recall events must perform substantial due diligence. Risks must be evaluated, coverages and available add-ons thereto must be evaluated, and costs must be weighed. Prospective policyholders must take the time up front to conduct a careful evaluation of available insurance products. Every company in the food industry faces these risks—potentially catastrophic loss, liability from food contamination or recall, or both—but those that conduct appropriate due diligence can ensure their business is adequately protected.

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[8] See, e.g., *Nat’l Union Fire Ins. Co. v. Terra Indus., Inc.,* 346 F.3d 1160, 1165 (8th Cir. 2003) (holding that liability arising from benzene-contaminated carbon dioxide incorporated into soft drinks was caused by “property damage”); *United Sugars Corp. v. St. Paul Fire & Marine Ins. Co.,* No. A06-1933, 2007 Minn. App. Unpub. LEXIS 660, at *15 (Minn. Ct. App. June 26, 2007) (introduction of contaminated ingredient that rendered cookie dough unsalable constituted “property damage” to the dough). A closer question is whether a recall due to the possible contamination of the policyholder’s product constitutes covered “property damage.” Under the FDA’s recall system, a “Class III” recall involves “a situation in which use of or exposure to a violative product is not likely to cause
adverse health consequences.” U.S. Food & Drug Admin., Safety: Background and Definitions (last updated June 24, 2009). Still, the mere possibility of coverage should trigger the insurer’s duty to defend.

[14] See, e.g., R.L. Hess Co. v. U.S. Paper Converters, 1995 Wisc. App. LEXIS 222, at *4 (Wis. Ct. App. 1995) (finding the updated language in the exclusion determinative as to a third-party recall); but see Netherlands Ins. Co. v. Main St. Ingredients, LLC, 745 F.3d 909, 918 (8th Cir. 2014) (recall not of “your product,” but rather to policyholder’s customer’s product); Sec. Nat’l Ins. Co. v. GloryBee Foods, Inc., No. 09-1388-HO, 2011 U.S. Dist. LEXIS 27267, at *3 (D. Or. Mar. 15, 2011) (finding the exclusion inapplicable because of its reference to “impaired property,” which indicated the parties’ intent was that “the exclusion [] apply to damage claims related to products of others only when the insured’s product was not inextricably incorporated into such product”).
[16] See, e.g., Source Food Tech., Inc. v. U.S. Fid. & Guar. Co., 465 F.3d 834, 838 (8th Cir. 2006) (finding no physical damage where policyholders’ product was uncontaminated but unsellable due to outbreak at another Canadian beef supplier); but see Pillsbury Co. v. Underwriters at Lloyd’s London, 705 F. Supp. 1396, 1399 (D. Minn. 1989) (rejecting insurers argument that soup was not physically damaged where the policyholder’s newly implemented quality control procedure identified potential contamination, but manufacturing process had not changed).
function of a product is impaired, direct physical loss may exist without actual destruction of or structural damage to the property).


[24] It should be noted that the ISO introduced in 2004 a separate product titled the “Product Withdrawal Coverage Form.” Offering coverage for “Product Withdrawal Expense” and “Product Withdrawal Liability,” the form is designed specifically to fill the gaps in traditional coverage. Nevertheless, no written decisions have apparently considered coverage under the ISO form, and it is uncertain how many insurers, if any, offer such coverage. The ISO form has most likely provided guidance to insurers in drafting their own manuscript coverage. See, e.g., Craig F. Stanovich, “The New ISO Commercial General Liability Policy: A Summary of December 2004 Policy Changes,” IRMI (Oct. 2004) (last visited July 13, 2015).


[26] See Ruiz Food Products, 2012 U.S. Dist. LEXIS 131031 (finding no coverage where policyholder recalled products due to the incorporation of potentially, but ultimately not salmonella-infected seasoning).


[29] Hot Stuff Foods, 771 F.3d at 1073.


[31] Hot Stuff Foods, 771 F.3d at 1076.


[33] Hot Stuff Foods, 771 F.3d at 1078.


[38] Windsor Food Quality, 234 Cal. App. 4th at 1182.


[51] See also Catlin, Product Contamination Policy, at 5 (last visited July 13, 2015) (requiring in its standard form contamination that “has resulted in or would result in
clearly identifiable internal or external physical symptoms of bodily injury, sickness, disease or death of any person(s) within three hundred and sixty five days” following consumption).
