Double-Check Your Product Contamination Insurance Policy: You May Not Be Covered for Contamination-Based Recall Expenses

Food contamination and product recall can be a food and beverage company's worst nightmare. An outbreak of a foodborne illness linked to a company's product, even mistakenly, can have devastating effects on the company's brand and public image. With an average of ten food-related recalls per week, purchasing the right insurance policy to cover a recall emergency is an absolute necessity. Recently, in *Windsor Food Quality Co. Ltd. v. The Underwriters of Lloyds of London, et al*., the California Supreme Court continued a national trend of decisions denying coverage for potential contamination incidents under product contamination insurance ("PCI") policies. Companies operating in today's food industry must understand the limits of a PCI policy. Later this summer, the Food and Drug Administration will begin implementing the Food Safety Modernization Act, signaling the largest change in the food industry's regulatory climate in nearly a century. As regulatory activity increases, so too will compliance-based recalls.

Background of Windsor

Windsor Food Quality Company, Ltd. ("Windsor") manufactured frozen food products using ground beef supplied by Westland/Hallmark Meat Company ("Westland"). In 2008, the U.S. Department of Agriculture ("USDA") announced a voluntary recall of all products containing Westland ground beef after discovering Westland used nonambulatory, disabled cattle, or "downer" cows, that may have been infected with bovine spongiform encephalopathy, commonly known as mad cow disease. Windsor recalled its products containing Westland ground beef, incurring approximately $3 million in recall expenses. However, no injuries stemming from the consumption of Westland's ground beef were reported.

Windsor maintained a PCI policy from The Underwriters of Lloyds of London ("Lloyds"). The policy covered "Insured Products," defined 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…." (Emphasis added.) The policy also covered accidental product contamination from adulterated ingredients supplied by a third party, provided some injury stemming from the contamination is

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reported within 120 days.

Lloyds denied Windsor coverage because any potential contamination caused by Westland occurred *before*—not during or after—Windsor manufactured its frozen food product. Windsor filed a declaratory judgment action against Lloyds to recover its recall expenses. The trial court found no evidence of a public health risk or product tampering, and therefore determined that the recalled products were not an "insured product" under the PCI policy.

The California Court of Appeal's Decision

The Court of Appeal for the Fourth Appellate District of California affirmed the trial court's decision for three reasons. First, the contamination was not of an "Insured Product" because Windsor did not show that the product was contaminated during or after manufacture. Second, the recall was based on Westland's failure to notify the USDA of Westland's use of "downer" cows, rather than any actual, proven contamination of Westland's ground beef or Windsor's final product. Third, even if Westland's ground beef had been contaminated, no injuries stemming from the consumption of Westland's ground beef (in Windsor's frozen food products or otherwise) had been reported within 120 days of consumption. On May 20, 2015, the California Supreme Court denied Windsor's petition for review with no explanation, thereby affirming the Court of Appeal's reasoning.

How Does This Affect Your Company?

Food growers, food shippers, food manufacturers, grocers and restaurants need to be diligent when purchasing insurance. A PCI policy likely does not include coverage for recalls involving potential contamination. PCI policies typically cover accidental contamination, malicious tampering, and product extortion during manufacture or processing where consumption has resulted in, or likely would result in, bodily injury or property damage. PCI policies typically do not cover recalls for any other reason because the insurance industry views the recalling of contaminated or adulterated products as an inherent risk of doing business in the heavily regulated food industry.

To manage future risk responsibly, it may be wise to heed Windsor's warning and take some of the following precautions:

- **Consult an Insurance Expert Before Purchasing a Policy**. Windsor exemplifies how vulnerable even a sophisticated food manufacturer with massive liability exposure and significant insurance can be to a recall crisis. Consulting an experienced insurance expert familiar with the food industry and its regulatory landscape can be the difference between coverage and crippling out-of-pocket expenses.

- **Read and Periodically Review Your Insurance Policy**. Familiarize yourself with the language of your insurance policy before purchase and periodically review your insurance portfolio with your Reinhart attorney or an insurance expert who understands the specific liability risks associated with your business. Business growth or supply chain modification can change your insurance needs. Confirm that your insurance portfolio covers what you think it does.
- **Consider Diversifying Your Insurance Portfolio**. Food manufacturers whose finished product incorporates ingredients handled elsewhere should consider adding a recall policy to their insurance portfolio. Recall policies typically cover the recall expenses associated with both actual and potential contamination. An adverse publicity policy can be a valuable complement to your recall policy, considering the devastating effects a product recall can have on a company's brand and public image.

If you have questions about the topics covered in this e-alert, please contact your Reinhart attorney or any member of the firm's Food and Beverage Law Group.