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CALIFORNIA SUPERIOR COURT HOLDS INSURERS LIABLE FOR RECALL POLICY'S $12 MILLION LIMIT FOR E. COLI-CONTAMINATED SPINACH RECALL LOSSES

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A California Superior Court recently found that certain London market insurers were liable to Fresh Express, Inc. ("Fresh Express") for the full $12 million limits under the terms of a "Total Recall + Brand Protection Food / Beverage Policy" (the "Policy"). *See Fresh Express, Inc. v. Beazley Syndicate 2623 / 623 at Lloyd's,* Case No. M88545 (Cal. Sup. Ct. Aug. 18, 2009).

Fresh Express is the largest seller of fresh bagged spinach in the United States, and in September 2006, a nationwide outbreak of *E. coli* bacteria linked to fresh bagged spinach occurred. *Fresh Express,* Case No. M88545 at 1-2. On September 14, 2006, the Food and Drug Administration ("FDA") advised the public not to eat all brands of fresh bagged spinach, including that sold by Fresh Express. *Id.* The FDA's advisory was in place until September 29, 2006. *Id.* at 2.

Upon learning of the outbreak, Fresh Express conducted several internal investigations and determined that it had violated its own food safety policies in acquiring and processing raw spinach. *Id.* First, Fresh Express failed to conduct a food safety audit of a Seco Packing field prior to purchase to confirm the growers had complied with Fresh Express' own "Good Agricultural Practices." *Id.* at 5. Additionally, Fresh Express purchased spinach from a "prohibited field" that was too close to a cattle feed lot, a known source of *E. coli*. *Id.* Fresh Express concluded that because of these errors, there was reasonable cause to believe that its products may cause injury to consumers. *Id.*

Fresh Express provided Beazley Syndicate 2623 / 623 at Lloyd's and QBE International Insurance Limited, now known as QBE Insurance (Europe) Ltd. (collectively, "Insurers") with notice of a claim for losses under the Policy in September 2006. *Id.* at 3. The Insurers issued a reservation of rights letter and requests for additional information on October 18, 2006. *Id.* Fresh Express responded to the reservation of rights letter on November 8, 2006, and provided the requested information. *Id.* The Insurers denied the claim on January 4, 2007, and Fresh Express requested a reconsideration on January 26, 2007. *Id.* The Insurers confirmed their denial on March 1, 2007. *Id.*

Fresh Express filed suit against the Insurers on January 15, 2008, alleging that the Insurers breached the terms of the Policy and that the Insurers breached their duty of good faith and fair dealing. *Id.* at 3-4. The Policy contained three types of "Insured Event," one of which was "Accidental Contamination." *Id.* at 2. The Policy defined "Accidental Contamination" as:

> Error by the Assured in the manufacture, production, processing, preparation, assembly, blending, mixing, compounding, packaging or labeling (including instructions for use) of any Insured Products whilst in the care or custody of the Assured which causes the Assured to have reasonable cause to believe that the use or consumption of such Insured Products has led to or would lead to:
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> (i) bodily injury, sickness, disease, or death of any person(s) or animal(s) physically manifesting itself by way of clear, obvious or visible symptoms within 120 days of consumption or
>
> (ii) physical damage to or destruction of tangible property (other than the Insured Products themselves).

Id. at 2. The Policy contained a $12 million limit for "Accidental Contamination" per Insured Event and in the aggregate. *Id.*

The Insurers argued that Fresh Express did not commit any "errors," did not have "reasonable cause to believe" its products may cause bodily injury and did not suffer any losses covered by the Policy. *Id.* at 4. The Insurers also argued that to the extent there were any "errors," they were not committed in the course of "manufacture, production, processing, preparation, assembly, blending, mixing, compounding, packaging or labeling" of Fresh Express' products. *Id.* Further, the Insurers asserted that Fresh Express failed to give timely notice. *Id.*

The court rejected the Insurers' arguments, first reasoning that Fresh Express had committed "errors" by failing to comply with its own food safety policies. *Id.* at 5. Next, the court found that Fresh Express' food safety policies were an integral and inseparable part of its safe manufacturing processes. *Id.* Additionally, the court reasoned that Fresh Express mixed the potentially contaminated spinach it purchased from Seco Packing and the prohibited lot with other spinach sources. *Id.* As a result, the court concluded that such mixing clearly resulted in errors in "blending, mixing, [and] compounding," sufficient to satisfy the Policy's error requirement. *Id.* The court further found that Fresh Express had reasonable cause to believe that consumption of its product may cause bodily injury, as the consequences of consuming *E. coli*-contaminated spinach included sickness, kidney failure and even death. *Id.* at 6.

The court rejected the Insurers' late-notice defense, reasoning that the Insurers failed to request any information regarding "errors" committed by Fresh Express, and noting that the Insurers did not accept Fresh Express' invitation to visit Fresh Express' facility. *Id.* The court also disagreed that a "governmental ban" or "loss of confidence" exclusion applied, as there was no evidence the FDA advisory constituted a "ban," and the FDA did not have the authority to ban any spinach. *Id.* at 7. The court further noted that application of the Insurers' interpretation of the Policy to exclude coverage for "loss of confidence" would render coverage for lost gross profits and brand rehabilitation meaningless. *Id.* Because the court found that Fresh Express presented sufficient evidence that it sustained losses in excess of the Policy's $12 million limit, it awarded Fresh Express damages up to the full amount of the limit.

With respect to Fresh Express' bad faith claim, the court found that Fresh Express failed to demonstrate that Insurers acted unreasonably and without cause in delaying or denying policy benefits. *Id.* at 9. The court reasoned that the 2-month time period between Fresh Express' November response to the reservation of rights letter and the Insurer's January denial was not unreasonable in light of the claim's complexity and the timing over a holiday period. *Id.* The court also reasoned that the persons handling the claim for the Insurers had considerable experience in managing product recall claims, that Fresh Express had ample opportunity to supply any probative information, and that the Insurers did not deliberately deceive or manipulate Fresh Express. *Id.* at 11-12. As a result, while the court stated it could not "put a stamp of approval on [the Insurers'] actions," it concluded that the Insurers did not act in bad faith. *Id.* at 13.

The decision is significant in that it is an early test of one of the food contamination/product recall specialty policies recently available in the marketplace. The decision must be closely scrutinized as to the facts involved, policy language at issue and positions taken. The decision is also significant in regard to the issues raised in the handling of crisis management matters.

For a further analysis of coverage issues involving food contamination, product recall and crisis management claims, please contact Joe Bermudez, Jason Melichar or Suzanne Meintzer of Cozen O'Connor's Denver, Colorado office. Cozen O'Connor is a nationally recognized leader in representing the insurance industry in all coverage areas.