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Spoiled Rotten: Courts Are Split on Coverage for Contaminated Foods and Products

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By Joseph F. Bermudez, Suzanne Meintzer and Samantha Evans

In a series of recent cases addressing coverage for contaminated foods and similar losses, jurisdictions have split on the availability of insurance. Courts excluding coverage have relied on language traditionally used to exclude business and product-related losses, including the "your product" and "impaired property" exclusions. Other courts have rejected the application of these exclusions if it is unclear that the damage was to the insured's product and if the cause of the damage is not inherent in the product itself.

'Your Product' Exclusion

For example, in the recent decision of *Tradin Organics USA, Inc. v Maryland Cas. Co.*, 2008 U.S. Dist. LEXIS 5820 (S.D.N.Y. Jan. 29, 2008) (applying New Hampshire law), Canadian-based Crofters Food Ltd. ("Crofters") purchased 80 metric tons of raspberry crumble from Tradin Organics USA, Inc.'s ("Tradin") Amsterdam-based parent. In order to fulfill the order, Tradin subcontracted with a Serbian company, which agreed to deliver the crumble directly to Crofters.

After Crofters accepted delivery of the crumble, the crumble "was discovered to contain plastic, pits, cherry stems, glass and other materials, and the Canadian government ordered it recalled." Tradin agreed to compensate Crofters for the contaminated crumble, and then filed a claim with Maryland. Maryland denied coverage under the "your product" exclusion, which excluded coverage for "any property damage due arising out of it or any part of it." The policy defined "your product" as "any goods or products … manufactured, sold, handled, distributed or disposed of by" Tradin. Tradin then brought breach of contract and bad faith claims against Maryland, asserting that it had a right to full reimbursement of the settlement amount. Both parties moved for summary judgment.

In granting summary judgment for Maryland on Tradin's breach of contract claim, the court determined that while New Hampshire law applied, New Hampshire courts had not addressed the "your product" exclusion. Looking to New York law and other jurisdictions, the court found that the "your product" exclusion unambiguously precludes coverage for "losses caused by a contaminated or defective product sold by the insured," including the crumble. Similarly, the court also held that coverage was excluded under the plain language of the policy, which defined "your product" as "any goods or products … manufactured, sold, handled, distributed or disposed of by" Tradin or others using Tradin's name. Because it was "undisputed that Tradin sold the food to Crofters," the policy excluded coverage.

Impaired Property Exclusion

Similarly, in *Lavoi Corp. v. National Fire Ins. of Hartford*, 666 S.E.2d 387, 395 (Ga. Ct. App. 2008), the Georgia Court of Appeals recently upheld an insurer's denial of coverage for claims related to the use of contaminated bread through application of Exclusion m, the impaired property exclusion. National Fire Insurance of Hartford ("Hartford") and Continental Casualty Company (collectively "CNA") insured Lavoi Corporation ("Lavoi"), which provided contaminated bread to a franchise sandwich restaurant. The restaurant asserted several causes of action against Lavoi, including breach of warranty, strict liability, deceptive trade practices, interference with business relations, and violation of federal anti-trust laws. After Lavoi tendered its defense to CNA, CNA denied coverage, relying on Exclusion m. Exclusion m excluded coverage for property damage to impaired property arising out of a defect, deficiency, inadequacy or dangerous condition in the insured's product or work. Impaired property was defined to include property that could not be used or was made less useful because it incorporated the insured's work or product.

On appeal, Lavoi first argued that the restaurant may have been able to prove that the contaminated bread caused bodily injury to its customers. The Georgia Court of Appeals rejected the insured's argument, reasoning that "[t]here is no

allegation in the complaint that any … customers sustained bodily injury."

The court also held that the insured could not demonstrate allegations of "property damage." Rather, it noted that the underlying complaint did not allege property damage in the form of damaged or returned sandwiches. Even if it had, returned or damaged sandwiches would fall within the definition of impaired property because the sandwiches were rendered less useful because they incorporated the insured's contaminated bread. Thus, any property damage resulting from the sandwiches would have been excluded under exclusion m. Because the Complaint failed to allege any covered damage under the terms of the policy, the appellate court affirmed the trial court's entry of summary judgment on the insured's bad faith claim.

Causation Unclear

In contrast to *Tradin*, the U.S. District Court for the Eastern District of California recently refused to apply various exclusions to exclude coverage for an insured's pitted nectarines when the cause of the contamination or defect was unclear. *Gerawan Farming Partners a Westchester Surplus Lines Ins. Co., et al.*, No. 05-1186, slip op., 2008 WL 80711 (E.D.Cal. Jan. 4, 2008). Gerawan Farming Partners, Inc. ("Gerawan") owned, grew, packed, and processed stone fruit, such as nectarines. In August 2003, Gerawan discovered that a number of its nectarines were suffering from "pitting," a cosmetic problem that affects the surface of the fruit and is characterized by multiple small craters on the surface. Although pitting is not uncommon, in 2003 there was an explosion of pitting beyond what had occurred in prior years. Gerawan made a claim under its all-risk commercial property policy issued by Westchester Surplus Lines Ins. Co. ("Westchester"), which Westchester denied because Gerawan was unable to show a covered cause of loss. It also relied upon approximately 14 policy exclusions.

The court noted that the policy provided coverage for direct physical loss of or damage to covered property caused by or resulting from any covered cause of loss. In discussing the initial grant of coverage, the court rejected Westchester's argument that Gerawan was required to show that the loss of the nectarines was caused by a covered peril. Because the "covered cause of loss" definition essentially duplicated the requirement of a physical loss or damage, the court reasoned that the policy covered all risks of direct physical loss, unless otherwise excluded or limited. As such, because the pitting is a physical condition that caused the loss of, or damage to, the nectarines, the court held that Gerawan had met its burden of showing a covered loss.

The court next addressed Westchester's arguments that the latent defects and growing crop exclusions applied because expert opinions established that growing conditions in the field caused the nectarines to develop weakened lenticals not observable to the naked eye, thereby later causing the pitting. In denying summary judgment for Westchester, the court noted that the parties' experts disagreed as to the cause of the pitting, as Gerawan submitted evidence that the pitting occurred only after its packing and processing procedures were applied to the nectarines. Because the pitting may have been caused by extraneous factors not inherent in the nectarines, the court held that summary judgment would not be appropriate. Similarly, the court held that the exclusion for growing crops, which applies to damage done to crops that are unharvested or unsevered from the land, is not applicable because the pitting occurred after harvest and after the nectarines were subjected to Gerawan's packing and processing procedures.

Several Coverage Issues

In *Stark Liquidation Co. v. Florists' Mutual Ins. Co.*, No. ED87852 (Mo. Ct. App. Aug. 14, 2007), the Missouri Court of Appeals construed several coverage issues in the context of contaminated foods, including the definition of "occurrence," trigger and the business risk, sistership and loss of use exclusions. In *Stark*, the court held that an insurer was required to defend a loss of use property damage claim asserted against its insured for damages caused by the failure of bacterially infected apricot trees to produce fruit.

James Duffin ("Duffin") purchased approximately 3,500 apricot trees from Stark Liquidation Company ("Stark"), and then planted them on half of his 40-acre plot. Although the trees grew and developed over the next three years, they either failed to yield commercially sufficient quantities of fruit or yielded no fruit at all. When Duffin complained about the problems to Stark, Stark tendered the claim to Florists' Mutual Insurance Company ("Florists'"), which insured Stark under a broad form CGL policy, effective between June 1, 1993 and Nov. 15, 1994. Florists' denied the claim because the trees' failure to yield fruit did not constitute an "occurrence" and did not occur within the policy's effective dates.

Duffin asserted that Stark negligently failed to test for bacterial canker; negligently brought bacterial canker to the orchard; and negligently failed to test the trees to determine whether they were self-pollinating. Stark tendered Duffin's suit to Florists', which again denied coverage, additionally asserting that a "Seed Merchant Errors & Omissions" exclusion barred coverage. Stark tendered Duffin's claim to Florists' two more times, which continued to deny coverage, further contending that the "Loss of Use" exclusion also applied to bar coverage.

During settlement negotiations with Duffin, Stark advised Florists' that a report had concluded that bacterial canker was present in the apricot trees. Although Stark informed Florists' that bacterial canker may have caused Duffin's damages and that the parties had entered settlement negotiations, Florists' did not investigate the claim, and it was eventually settled. Duffin agreed not to execute on any judgment entered against Stark in exchange for an assignment of Stark's rights under the Florists' policy. Ultimately, an arbitrator found in favor of Duffin, concluding that the apricot trees were infected with bacterial canker when they arrived at the orchard; that the canker spread from the apricot orchard to an adjoining nectarine orchard; and that Stark's failure to test for bacterial canker caused sudden and repeated exposure of the entire orchard. A California court then confirmed the arbitration award, and entered judgment against Stark.

In the ensuing coverage action, Stark sought a declaration that Florists' policy covered Duffin's claims. Duffin intervened as a necessary party-plaintiff, and the trial court entered summary judgment in favor of Stark and Duffin. On appeal, Florists' argued, in part, that Duffin's damages did not constitute an "occurrence"; that Duffin's claim fell outside the policy period; and that the "Your Products," "Loss of Use," and "Seed Merchant Errors & Omissions" exclusions applied to bar coverage. The Missouri Court of Appeals rejected each argument.

First, the court reasoned that Stark's negligent sale of bacterially contaminated apricot trees constituted an "occurrence." Because the claim did not involve bodily injury, the court applied a continuous trigger theory, reasoning that the injury began with delivery of the contaminated trees and continued until Duffin's discovery that the trees could not bear fruit. Because Duffin alleged the trees were infected at the time of delivery in 1994, the policy was triggered, and Florists' had a duty to defend.

The court then reasoned that the first section of the "Your Products" exclusion did not apply because Duffin sought coverage for damage to property other than for the apricot trees themselves. The court also reasoned that the sistership section of the "Your Products" exclusion did not apply because Stark did not withdraw or recall the trees from the market. The court further concluded that the "Loss of Use" exclusion also did not bar coverage because Duffin's claim — that Stark's negligent introduction of bacterial canker into the apricot trees caused Duffin to suffer loss of use of his orchard — fell within the exception to the exclusion. Finally, the court found that the "Seed Merchant Errors & Omissions" exclusion did not apply because Stark did not "manufacture, sell, handle or distribute seeds" with respect to Duffin's claim.

Conclusion

This recent series of cases addressing coverage for contamination and other similar losses demonstrates a potential split in the courts' willingness to apply the business risk exclusions. As *Tradin* indicates, the "your product" exclusion may unambiguously exclude coverage if the damage occurs to the insured's food product. *Lavoi* further demonstrates that damage because of contaminated products may be excluded under the impaired property exclusion if incorporated into another product. However, and as *Gerawan* and *Stark* illustrate, these exclusions may not apply if it is unclear that the claimed damage occurred to the insured's product or was the result of an inherent defect in the product itself. With the likely growth in the number of cases addressing contaminated products, future decisions are certain to shed more light on the application of these exclusions.

Joseph F. Bermudez is a Member in the Cozen O'Connor Global Insurance Group; **Suzanne Meintzer** and **Samantha Evans** are associates in the Cozen O'Connor Global Insurance Group.