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THE THIRD CIRCUIT INTERPRETS *KVAERNER* , HOLDS THAT CLAIM FOR CONSEQUENTIAL DAMAGES BASED ON SALE OF DEFECTIVE NUTRITIONAL SUPPLEMENT DOES NOT CONSTITUTE AN "OCCURRENCE" UNDER A CGL POLICY

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On April 14, 2009, the Third Circuit Court of Appeals issued its opinion in *Nationwide Mutual Ins. Co. v. CPB International, Inc.*, No. 02-4772 (3d Cir. 2009), further reducing the availability of general liability coverage for disputes between contracting parties. The Court's decision is significant in three respects: (1) it expands the reach of *Kvaerner Metals Div. v. Commercial Union Ins. Co.*, 908 A.2d 888 (Pa. 2006) and *Millers Capital Ins. Co. v. Gambone Bros. Dev. Co.*, 941 A.2d 706 (Pa. Super. 2008), *pet. denied*, 219 MAL 2008 (Pa. Dec. 30, 2008) beyond the construction defect context to products claims; (2) it extends the "no occurrence" analysis to consequential damages, and (3) the Third Circuit designated its opinion as "precedential," thereby signaling to future parties its controlling effect.

The insured in *CPB International* was CPB, an importer and wholesaler of chondroitin, a nutritional supplement made from animal cartilage. CPB sued one of its customers, Rexall, for partial non-payment for two shipments of chondroitin. Rexall counterclaimed, alleging that the chondroitin was deficient, of improper composition, unusable for its intended purpose, and that the delivery of the material constituted a material breach of contract.

Rexall did not discover that the chondroitin was of improper composition until after it had already combined CPB's chondroitin with glucosamine and other ingredients to form nutritional tablets. Rexall valued the completed tablets at more than $991,015, and claimed they were rendered useless and without value. Rexall's counterclaim sought return of its initial $760,000 payment and consequential damages in an amount exceeding $1,195,465 for the shipment of the allegedly defective chondroitin.

CPB tendered the counterclaim to Nationwide, the insurer with whom it maintained commercial general liability coverage. Nationwide assumed the defense under a reservation of rights and filed a coverage action in the Middle District of Pennsylvania. The district court held in favor of Nationwide, finding that the action was based on obligations existing by virtue of a contract and, as such, did not arise from covered "occurrences."

CPB's argument on appeal acknowledged that under *Kvaerner*, Rexall's claim that CPB provided defective chondroitin, without more, would not survive the "occurrence" requirement. CPB sought to distinguish the claim against it from *Kvaerner* by arguing that "because Rexall's action alleged consequential damages, it came within the ambit of the policy." The Third Circuit disagreed:

> That argument is unpersuasive. The precise holding of *Kvaerner* is limited to claims that "aver[] only property damage from poor workmanship to the work product itself," 908 A. 2d at 900, but the foundation of that holding is that claims for faulty workmanship "simply do not present the degree of fortuity contemplated by the ordinary definition of 'accident' or its common judicial construction in this context." *Id.* at 899. In other words, it is largely within the insured's control whether it supplies the agreed-upon product, and the fact that contractual liability flows from the failure to provide that product is too foreseeable to be

> considered an accident. *See id*. Here, though the delivery of defective chondroitin is not considered an accident, *see id.*, CPB argues that Rexall's use of that product should be considered one. That distinction is inapposite. It is certainly foreseeable that the product CPB sold would be used for the purpose for which it was sold. Otherwise, Rexall would lack a claim for consequential damages. * * * Thus, "the degree of fortuity" here is no different than that involved in *Kvaerner*, 908 A.2d at 898.

The court cited to the *Millers Capital v. Gambone* decision as further proof that its conclusion comported with Pennsylvania law, stating: "The Superior Court of Pennsylvania, when confronted with an argument similar to the one that CPB makes here, reached the same conclusion[.]"

Before concluding, the court held that breach of contract does not qualify as an "occurrence" under Pennsylvania law, rejecting CPB's claim that the issue remained open even after *Kvaerner*. The Court further held that even if the breach of contract claim qualified as an "occurrence," it fit within the policy's contractual liability exclusion.

As a proud advocate for the insurance industry, Cozen O'Connor is pleased to report to you on this significant decision. Cozen O'Connor represented the insurer before the Pennsylvania Supreme Court in *Kvaerner*, and the insurer in *Millers Capital v. Gambone*.

For discussions of those decisions, please contact Deborah Minkoff at dminkoff@cozen.com, Jack Cohn at jcohn@cozen.com, or Joseph Arnold at jarnold@cozen.com. A full copy of Nationwide Mutual Ins. Co. v. CPB International, Inc. can be accessed at http://www.ca3.uscourts.gov/opinarch/074772p.pdf