

ALERT

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COZEN O'CONNOR PREVAILS IN VIRGINIA TRIAL AS COURT HOLDS FOOD CONTAMINATION CLAIM BARRED BY COMMERCIAL PROPERTY POLICIES' POLLUTION AND PRODUCT CONTAMINATION AND RECALL EXCLUSIONS

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On January 7, 2011, Judge Walter W. Stout, III, of the Circuit Court of the City of Richmond, Va., issued an opinion and order finding that Cozen O'Connor clients, ACE American Insurance Company (ACE) and Arch Insurance Company (Arch) owed their insured PBM Nutritionals, LLC (PBM) no coverage on its claim for roughly \$6 million in product contamination losses. *PBM Nutritionals, LLC v. Lexington Ins. Co.*, No. 09-5289, 2011 Va. Cir. LEXIS 16 (Va. Cir. Ct., Richmond, Jan. 7, 2011). Central to its holding was the court's determination that two exclusionary endorsements added to the broker's manuscript form by ACE and Arch applied to product contamination losses. In so holding, the court distinguished two unreported opinions from another Virginia trial court that had held that pollution exclusions found within CGL policies barred coverage only for traditional environmental pollution losses.

The action in *PBM Nutritionals* arose from contamination that occurred during PBM's manufacture of infant formula. In January 2009, PBM discovered that a leaking valve had allowed steam to enter a heat exchanger while it was shut down for a routine cleaning. The steam superheated water, which in turn melted a filter assembly. The disintegrated filter components were then released into the water. When PBM restarted its manufacturing process after the cleaning, it mixed the contaminated water with other infant formula ingredients. PBM quarantined and disposed of the baby formula after FDA-mandated tests revealed the presence of contaminants, and it then sought coverage for the loss under a "product contamination insurance" policy issued by Dornoch, Ltd. (Dornoch). PBM also filed a claim with its commercial property insurers, ACE, Arch, and Lexington Insurance Company (Lexington).

PBM settled its claim with Dornoch, recovering most of the replacement cost of the contaminated baby formula. The three property insurers denied PBM's claim, however, and litigation ensued. PBM alleged that ACE and Arch owed it roughly \$6 million under their policies, and it also sought bad faith damages. Cozen O'Connor attorneys Dick Bennett and Micah Knapp, along with local counsel Braxton Hill of the Richmond firm of Christian & Barton, LLP, represented ACE and Arch, which afforded 75 percent of the coverage provided under the property policy. The third property insurer, Lexington, which afforded the other 25 percent, was represented by separate counsel.

Over the course of a three-day bench trial in late October 2010, PBM argued that a pollution exclusion found within the body of its broker's manuscript form contained an exception for pollution resulting from a covered peril, rendering that particular exclusion inapplicable here because the property insurers admitted that the disintegration of the filters was a covered loss. PBM then contended that the pollution and contamination exclusions, which were located in endorsements to the policy added by all three property insurers, conflicted with the inapplicable exclusion found in the broker's manuscript form and thereby gave rise to an ambiguity that must be construed in favor of coverage. Relying upon two Virginia trial court opinions, PBM also argued that the pollution and contamination exclusions found within the three insurers' endorsements applied only to "traditional environmental pollution" and not to contamination loss to products.

At the trial, Cozen O'Connor's team argued that there was no conflict between the policies' exclusions, the manuscript form's pollution exclusion did not "create" coverage, and

the ACE and Arch exclusionary endorsements modified the coverage provided in the manuscript form. The team further argued that the plain language of the endorsements' pollution or contamination exclusions applied to bar coverage for pollution or contamination of products rather than so-called traditional pollution to land or water. They maintained that the court should apply the reasoning of the United States District Court for the Eastern District of Virginia in *Firemen's Ins. Co. v. Kline & Son Cement Repair*, 474 F. Supp. 2d 779 (E.D. Va. 2007) and hold that the pollution and contamination exclusions are not limited to traditional environmental pollution. Finally, Cozen O'Connor argued that product contamination and recall exclusions also found within the ACE and Arch policies barred coverage for the contaminated infant formula.

In the January 7, 2011 opinion, the court agreed with all of the team's arguments. Judge Stout rejected the assertion that the policies' endorsements conflicted with the exclusion in the manuscript form, and he also rejected the argument that the pollution and contamination exclusions applied only to "traditional environmental pollution" to land or water. As the court stated, "[t]he parties' post-trial briefs clearly show a split of opinion on this matter among different jurisdictions around that country; however, this in and of itself does not create an ambiguity warranting construction in favor of the insured." *PBM Nutritionals*, 2011 Va. Cir. LEXIS 16, *7. The court held that the pollution and contamination "endorsement[s] unambiguously include[] as a contaminant

or pollutant, the melamine and filter material that caused a loss of marketability to the infant formula." *Id.* Judge Stout also held that ACE and Arch's product contamination and recall exclusions precluded coverage for PBM's claim, and it awarded PBM just \$7200, representing the cost to replace the water filters themselves.

Counsel for policyholders in food contamination coverage cases will undoubtedly continue to argue that pollution exclusions found within property or CGL policies were intended to apply only to traditional environmental pollution to land or water. Policyholder counsel will also continue to assert that pollution exclusions are ambiguous in the application to food contamination losses and that they should be construed narrowly and in favor of coverage. *PBM Nutritionals* offers well-reasoned authority for the argument that pollution exclusions are unambiguous and that their plain meaning bars coverage for losses resulting from the contamination of food products.

For further analysis of the coverage issues in this case please contact William P. Shelley at wshelley@cozen.com or 215-665-4142, Global Insurance Group Department Chair, Richard C. Bennett at rbennett@cozen.com or 215-665-2114, or Micah Knapp at mknapp@cozen.com 215-665-5564. For more information on food contamination coverage issues, contact Joseph Arnold at jarnold@cozen.com or 215-665-2795, Global Insurance Group Food Contamination Practice Group Chair.