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A RETROSPECTIVE OF 2007 FOOD CONTAMINATION COVERAGE DECISIONS

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2007 was a catastrophic year for the food industry. The year started badly when the first recall was announced on January 2, 2007. U.S. Food and Drug Administration Recall – Firm Press Release, *Ho's Trading Inc. Recalls Home Special Health Soup Recipe (Dry Mix)*, Jan. 2, 2007. Shortly thereafter, the largest pet food contamination recall in history was announced. U.S. Food and Drug Administration Recall – Firm Press Release, *Menu Foods Issues Recall of Specific Can and Small Foil Pouch Wet Pet Foods*, Mar. 16, 2007. The year that devastated the U.S. food industry's safety reputation continued with an All-American list of contaminated food products that involved international, national and super-regional recalls including, but not limited to: a spinach recall involving 48 states and Canadian provinces; a peanut butter recall involving 47 states; and a pot pie recall involving 31 states. Apple pie appears to have been the one American standard that was not recalled last year. Of course, any 2007 food contamination highlight film would not be complete without Topps' recall of historic proportions, which involved 21.7 million pounds of hamburger, was the second largest ground beef recall and third largest food recall in U.S. history.

Was 2007 an aberration? Some think so, while others believe that things will continue to get worse. Theories as to why the food industry suffered such devastating losses last year are as varied as the recalled foods. Many blame the government, pointing fingers at the FDA and USDA for failing to protect the public from contaminated foods. Business trends involving the disappearance of small, local producers; critically extended supply lines; globalization; increased imported foods; and the consolidation and centralization of the nation's food producers and distributors have also been targeted. Other related trends, such as American's growing appetite for processed and fast foods, have also been discussed. Moreover, many of the recalls also involved food pathogens that recently evolved into deadly strains. Within the past generation, *E. coli* developed into a strain (O157:H7) that can be fatal to our most vulnerable citizens, infants and the elderly. Elizabeth Weise, *Food-Borne Bacteria Evolving, Becoming More Dangerous*, USA TODAY, Oct. 31, 2006. And, two strains of salmonella are now resistant to the antibiotics doctors feel comfortable giving children. *Id.*

The government and the food industry struggled last year to combat the general growing belief that our food supply is no longer the safest in the world. *No Increased*

Precautions After E. coli Outbreak, Associated Press, Sept. 12, 2007. This year we will see continued efforts by government leaders and industry members to change this perception as well as the reality.

The claims arising from last year's multitude of recalls will make their way to and through the courts during the course of this year. And, coverage decisions rendered last year will have an impact on these and future contamination claims. We have monitored the food contamination coverage decisions rendered last year and provide this retrospective with the hope that it will assist those who are managing and handling such claims.

From a coverage perspective, 2007 was an interesting year. Generally, the year did not produce or reveal any new significant trends. Nevertheless, certain previous trends were continued and other contentious issues were again addressed and debate continues. With last year's notable and significant increase in contamination recalls, we expect to see new trends develop over the course of the year in this emerging and evolving area of insurance coverage. But, we are getting ahead of ourselves. In 2007, contamination coverage decisions were rendered in the context of first-party, third-party and professional liability policies' coverages.

I. FIRST-PARTY PROPERTY/BUSINESS INTERRUPTION COVERAGE ISSUES:

A. The Fortuity Doctrine.

Who Contaminated My Cheese? The U.S. District Court of Colorado Held that the Insured Must Prove Loss of Contaminated Cheese Caused by a Fortuitous Event.

Senior District Judge Richard Matsch rejected an insured's argument that it was not necessary for it to prove an identifiable event causing the contamination of 8 million pounds of cheese stored in the insured's warehouse. In *Leprino Foods Co. v. Factory Mutual Insurance Co.*, No. 02-cv-01559, 2007 WL 2221158 (D. Colo. July 31, 2007), the cheese manufactured by the insured, Leprino Foods Co. ("Leprino"), developed an off-flavor and contained high concentrations of naturally occurring compounds that provide flavor in fruit drinks and similar products. *Leprino*, 2007 WL 2221158 at *1. Leprino sought to recover its \$13 million loss from an all-risk property policy issued by its insurer, Factory Mutual Insurance Company ("Factory Mutual"). *Id.* Factory Mutual denied coverage under the policy's contamination exclusion, which excluded coverage unless such damage directly results from other physical damage not excluded. *Id.*

In its motion for summary judgment, Leprino argued that the condition of the warehouse, which was poorly kept and contained open vats and spilled fruity concentrate, qualifies as "other physical damage" and that it was not required to prove an identifiable event causing the contamination. *Id.* In rejecting Leprino's argument, the court recognized that every all-risk insurance policy contains the implied requirement that the loss be fortuitous and that the insureds bear the burden of proof in proving a fortuitous loss. *Id.* Significantly, the court held that Leprino had not met its burden to prove

that the loss was fortuitous by the mere storage of other food products with the cheese. *Id.* Rather, the court concluded that Leprino was required to establish that some event or condition in the warehouse caused the contamination. *Id.*

The *Leprino Foods* decision is significant in that it held the insured to its burden of establishing that the loss was caused by a fortuitous event even where the insurer's denial of coverage is based upon an exclusion. Although an insurer undoubtedly bears the burden that an exclusion applies, an insured is not relieved of its obligation of identifying the cause of the purported fortuitous loss.

B. Period of Restoration.

A Fish Called Sushi. The U.S. District Court in Colorado Granted Summary Judgment in Favor of an Insurer on a Business Interruption Food Contamination Claim.

On June 18, 2007, the United States District Court for the District of Colorado granted summary judgment in favor of Maryland Casualty Company, holding that the business interruption clause in a first-party property policy only provides coverage until the insured resumes operations, and does not provide coverage for market consequences resulting from the insured's temporary cessation of business. *Brand Management, Inc. v. Maryland Casualty Company*, 05-cv-02293-REB-MEH, 2007 WL 1772063 (D. Colo. June 18, 2007). In so holding, the court rejected the insureds' argument that they were entitled to coverage for their alleged loss of business income after the period their operations were suspended. *Brand*, 2007 WL 1772063 at *3.

In *Brand*, the insureds operated a sushi-making business that suffered a *Listeria monocytogenes* ("Listeria") contamination incident that closed their business for a period of 15 days while their facility was cleaned and sanitized. *Id.* at *1. The insureds did not dispute that their facility was free of Listeria and was able to operate as it had prior to the contamination on the date it reopened, but claimed that they were entitled to coverage until it moved to a new facility because its largest customer refused to continue purchasing their product until the insureds relocated. *Id.* Alternatively, the insureds claimed that they were entitled to 30 days of additional coverage under the policy's Extended Period of Indemnity clause because their business was not operating at the same level as it had prior to the contamination incident. *Id.* at *3. Because Maryland refused to pay the insureds for loss of business income after the date the insureds resumed operations at the facility, the insureds filed suit for breach of contract and bad faith breach of insurance contract.

The policy at issue provided coverage for the actual loss of business income the insureds sustained due to the necessary suspension of operations during the period of restoration so long as the suspension was caused by a direct physical loss of or damage to the property. *Id.* at *2. Relying on a Fourth Circuit case, the insureds argued that the "due to the necessary suspension of operations" language only required that the lost income be traceable to the suspension of operations. *Id.* The court rejected this interpretation as unreasonable, holding that the policy unambiguously requires that (1) the

claimed business income loss be causally linked to the necessary suspension of operations, and (2) it be sustained during the period of restoration. *Id.* Although the phrase “necessary suspension of operations” was not defined in the policy, the court relied on *stare decisis* in finding that it is generally understood to connote a total cessation of business activity. *Id.* at *3. As such, the court held that coverage was terminated under the business interruption clause once the insureds were able to resume operations. *Id.*

The court also rejected the insureds alternative argument that they were at least entitled to the additional coverage provided by the policy’s Extended Period of Indemnity clause, which is not triggered unless, following restoration of the covered premises, there is a continued “impairment of ‘operations.’” *Id.* In rejecting that argument, the court ignored the insureds’ claim that they lost customers as a result of the contamination and focused on the definition of “operations” in the policy, which means “business activities occurring” at the insureds’ property. *Id.* Because there was no dispute that the insureds resumed full operation of their business, albeit with fewer customers, after their facility was free of Listeria, the court held as a matter of law that no impairment of “operations” existed to trigger coverage under the extended coverage clause. *Id.* As no genuine issue of material fact existed as to the insureds’ breach of contract claim, the court concluded that their bad faith claim could not survive summary judgment under Colorado law. *Id.*

The *Brand* decision’s significance is that it extends the general trend of limiting business interruption claims to the period of time an insured’s operations are *completely* suspended to the food contamination context. This decision is especially important because many policies that provide business interruption coverage do not define the phrase “necessary suspension of operations” and, therefore, it provides a well-defined benchmark for terminating coverage where an insured continues to suffer business losses after it resumes operations.

II. THIRD-PARTY LIABILITY COVERAGE ISSUES:

A. “Property Damage.”

What’s the Buzz About Cookie Dough? Minnesota Court of Appeals Applied First-Party “Physical Damage” Decision to Third-Party “Property Damage” Adulterated Food Case.

On June 26, 2007, the Minnesota Court of Appeals held that an adulterated food product that becomes legally unsaleable can be deemed “physically damaged” under a commercial general liability insurance policy. *United Sugars Corp. v. St. Paul Fire & Marine Ins. Co.*, No. A06-1933 (Minn. Ct. App. June 26, 2007).

In *United Sugars*, the largest marketer of industrial consumer sugar in the United States, United Sugars Corporation (“USC”), brought a breach of contract action against its insurer for coverage for alleged property damage to a customer’s food product. *United Sugars*, No. A06-1933, slip op. at *1.

The CGL policy at issue defined “property damage” as “physical damage to tangible property of others, including all resulting loss of use of that property.” *Id.* The policy did not define the term “physical damage.” *Id.*

In July 2004, USC’s customer, Nestlé, informed USC that it had shut down production of cookie dough because it had discovered bee parts and cigarette butts in USC’s sugar. *Id.* Nestlé concluded that the dough that had been produced using the contaminated sugar was “adulterated” under the Food and Drug Administration’s regulations and, therefore, could not be legally sold. *Id.* USC agreed that the cookie dough could not be legally sold due to contact with the contaminated sugar, but neither USC nor Nestlé performed any testing to determine whether the contaminants were actually mixed in with the cookie dough. *Id.*

Nestlé then submitted a \$760,000 invoice to USC, claiming damages for loss of “cookie dough and raw ingredients, cleaning production equipment, and storage of the cookie dough prior to [its] destruction.” *Id.* USC tendered the claim to its insurer, which denied coverage on several grounds, including that “property damage” had not occurred. *Id.* at *2. USC subsequently brought suit against its carrier. *Id.*

In the coverage action, both parties moved for summary judgment. The trial court denied the insurer’s motion and entered partial summary judgment in favor of USC, reasoning that if Nestlé’s property was contaminated by USC’s sugar, then there would be coverage for the claimed loss. *Id.* However, the trial court also concluded that whether the dough was actually contaminated by the sugar was a genuine issue of material fact. *Id.* At trial, the special verdict form submitted to the jury contained only one question: “On or about July 9, 12, or 13 was Nestlé’s cookie dough contaminated with foreign matter by [USC’s] product?” *Id.* The jury answered “No,” and as a result of the verdict, the trial court entered judgment in the insurer’s favor. *Id.* The trial court also concluded that the insurer did not breach its duty to defend and denied USC’s motion for a new trial. *Id.*

On appeal, the Minnesota Court of Appeals applied the definition of “physical damage” previously used in a first-party property policy case, *General Mills, Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147 (Minn. Ct. App. 2001). In *General Mills*, the Food and Drug Administration found traces of a chemical that was not harmful to consumers in cereal produced by oat stocks, but that had not been approved for use on oats. *General Mills*, 622 N.W.2d at 150. Although the insurer argued that there was no “physical damage” because the cereal could be safely consumed, the court disagreed, reasoning that “direct physical loss can exist without actual destruction of property . . . it is sufficient to show that the insured property is injured in some way.” *Id.* at 152. The court concluded that the fact that the cereal could not be legally sold was sufficient to support a finding of physical damage. *Id.*

In *United Sugar*, despite the insurer’s objections that *General Mills* involved a first-party property policy and not a third-party liability policy, the Minnesota Court of Appeals applied the *General Mills* definition of “physical damage” and held that “an adulterated food product can be deemed physically

damaged because it is legally unsaleable.” *United Sugar*, No. A06-1933, slip op. at *3. The court also concluded that the special verdict form submitted to the jury did not accurately reflect the law as stated in the *General Mills* case, “i.e., that mere exposure of a food product to contaminants supports a finding of physical damage as that term is used in an insurance policy.” *Id.* at * 5-6. Therefore, the court concluded that USC was entitled to a new trial. *Id.* at *6.

The *United Sugar* court also held that the partial summary judgment entered in favor of USC, combined with the trial court’s determination that a material fact existed concerning whether the dough was actually contaminated, compelled the conclusion that the insurer had breached its duty to defend USC. *Id.* Therefore, the court reversed the trial court’s determination that the insurer had not breached its duty to defend and remanded the case for a determination of whether USC was entitled to an award of attorneys’ fees. *Id.*

The *United Sugar* decision continues the national debate as to what damages or losses constitute “property damage” in the context of contaminated food claims. Issues regarding the incorporation doctrine, technical violations of government regulations and the extent of which damages fall within the scope of coverage will frequently be at issue in the food contamination context. Though we do believe that this decision will be generally followed, it does raise several issues for discussion as to the types and extent of damages that can be construed to constitute “property damage” under a general liability policy.

B. “Occurrence.”

Celebrity Drink Failed Drug Test. The U.S. District Court of the District of Oregon Found an Occurrence When a Diet Drink Failed to Conform to Japanese Regulations.

The court in *Naumes, Inc. v. Chubb Custom Ins. Co.*, No. 05-1327-HA, 2007 U.S. Dist. LEXIS 1292 (D. Or. Jan. 5, 2007), concluded that an insured’s “erroneous introduction of a premix containing substances banned in the market for which the product was intended” was an “occurrence” that led to the destruction, and loss of use, of tangible property. *Naumes*, 2007 U.S. Dist. LEXIS 1292 at *13-14. *Naumes, Inc.* (“Naumes”) supplied a concentrate/pre-mix to a beverage manufacturer which incorporated the pre-mix into a diet drink sold by the name *The Original Hollywood Celebrity Diet Drink*. Tens of thousands of bottles of the beverage were purchased by an entity that sought to introduce the diet drink to the Japanese market. This entity required that the beverage conform to Japanese food and drug regulations. *Id.* at *3. The Japanese regulations required that such drinks contain neither biotin nor synthetic Vitamin E, and when Japanese authorities compelled a recall of the drinks because they contained both, Naumes’ was sued for delivering a non-conforming product. *Id.* at *3-4.

Naumes tendered the defense of its customer’s claims to Chubb Custom Insurance Company (“Chubb”), which disclaimed any obligation to defend Naumes as the underlying complaint did not allege an “occurrence,” “property damage” and was excluded by the Impaired Property exclusion. *Id.*

at *1. The court reasoned that the mistaken introduction of the biotin- and Vitamin E-containing mix was an unexpected consequence that led directly to the loss of the customer's product. *Id.* at *12-14. Thus, there was an "occurrence" that led to destruction of tangible property, and the court concluded that Chubb was required to defend Naumes. *Id.* Further, the court also reasoned that the impaired property exclusion did not apply because there was no evidence the diet drink could have been restored to use by repair, replacement or removal of Naumes' product. *Id.* at *14-15.

The *Naumes* decision addresses several issues that are frequently involved with food contamination claims. A majority of courts have held that the mere incorporation of an insured's product as a component in a product is not property damage. *Id.* at *11. Issues arise when, as here, the food product is not harmful to consume, but there is a technical violation of food regulations and the product could no longer be sold as originally planned. Certain courts have found that in such circumstances, coverage is afforded under liability policies. As new laws addressing food safety will likely be put into place over the next few years, we believe this issue will become highly significant and will be addressed by courts around the country.

The *Naumes* decision also addressed the application of one of the business risk exclusions, here the impaired property exclusion, in the food contamination context. Due to the nature of the food industry, business risk exclusions will frequently be at issue. Courts strictly construe the business risk exclusions requiring that an insurer show that every element of the exclusion is satisfied before it will apply the exclusion and exclude coverage.

No Fruit From the Poisonous Tree Coverage? Missouri Court of Appeals Concluded that an Insurer is Required to Defend and Indemnify a Loss of Use of Property Damage Claim Arising Out of the Failure of Bacterially-Contaminated Apricot Trees to Produce Fruit.

In *Stark Liquidation Co. v. Florists Mutual Ins. Co.*, No. ED87852, 2007 WL 2990459 (Mo. Ct. App. Oct. 16, 2007), the Missouri Court of Appeals recently held that an insurer is 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.

In *Stark*, James Duffin ("Duffin") purchased approximately 3,500 apricot trees from Stark Liquidation Company ("Stark"), and then planted them on half of his forty-acre plot. *Stark*, 2007 WL 2990459 at *1. 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. *Id.* 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 November 15, 1994. *Id.* 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. *Id.*

Duffin subsequently filed suit against Stark, and eventually amended his claims to assert 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. *Id.* Stark tendered Duffin's suit to Florists, which again denied coverage, additionally asserting that a "Seed Merchant Errors & Omissions" exclusion barred coverage. *Id.* 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. *Id.* at *2.

During settlement negotiations with Duffin, Stark advised Florists that a report had concluded that bacterial canker was present in the apricot trees. *Id.* 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. *Id.* Duffin agreed not to execute on any judgment entered against Stark in exchange for assignment of Stark's rights under the Florists' policy. *Id.* 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. *Id.* at *3. A California court then confirmed the arbitration award, and entered judgment against Stark. *Id.*

In the ensuing coverage action, Stark sought a declaration that the Florists' policy covered Duffin's claims. *Id.* Duffin intervened as a necessary party-plaintiff, and the trial court entered summary judgment in favor of Stark and Duffin. *Id.* 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." *Id.* at *4-5. 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. *Id.* at *5-6. Because Duffin alleged the trees were infected at the time of delivery in 1994, the policy was triggered, and Florists had a duty defend. *Id.* at *6.

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. *Id.* at *6-7. 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. *Id.* 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. *Id.* at *8. 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. *Id.* at *8-9.

The *Stark* decision will likely be relied upon in future food contamination cases and claims because it construes several coverage issues frequently raised in these claims, such as “occurrence,” trigger, business risk exclusions, sistership exclusion and loss of use exclusion.

Supplements “Made In China.” Pennsylvania Federal Court Holds That Claims That Are Contractual in Nature Do Not Constitute an Occurrence.

In *Nationwide Mutual Ins. Co. v. CPB Int’l, Inc.*, 2007 WL 4198173, slip op. (M.D. Pa. November 26, 2007), the court held that claims that are contractual in nature fail to meet the “occurrence” requirement for coverage and are excluded by the contractual liability exclusion. In this action, CPB imported from China chondroitin, a nutritional supplement sold to companies in the United States and combined with other ingredients to be sold as nutritional tablets. *CPB Int’l*, 2007 WL 4198173 at *1. CPB sued a manufacturer, Rexall, for failure to pay it for a shipment of chondroitin. Rexall counterclaimed against CPB, alleging that the delivery of chondroitin constituted a material breach of contract because when incorporated with other ingredients, it was discovered to be deficient and unusable for its intended purpose. *Id.* CPB tendered the counterclaim against it to its insurer, Nationwide, who filed this action for declaratory judgment seeking a declaration that it owed no duty to defend or indemnify CPB for breach of contract claims. *Id.*

While noting that the commercial general liability (“CGL”) policy at issue is applicable to property damage claims, the *CPB* court stated that coverage only exists to the extent “property damage” is caused by an “occurrence” under the policy. *Id.* at *4. As an “occurrence” is defined as an accident which is necessarily unexpected under its ordinary meaning, the court recognized that the definition implies a degree of fortuity that is absent in a claim for faulty workmanship. *Id.* Thus, the court continued, Pennsylvania courts have consistently held that a claim based on a breach of contract is not an accident or occurrence covered by the provisions of a CGL policy; rather, CGL policies typically provide coverage under such circumstances where the insured’s work or product *actively malfunctions*. *Id.* at *5. CPB, however, argued that the tort/contract distinction was not dispositive, noting that the “impaired property” exclusion would be meaningless if the insuring agreement of the CGL policy did not provide coverage for such occurrences. *Id.* at *6. The court rejected that argument, pointing out that the impaired property exclusion rendered CPB’s argument moot because the underlying claims stemmed from CPB’s providing a deficient product in breach of its contract with Rexall. *Id.* Moreover, the court noted that the exception to the exclusion explicitly clarified that accidental injury is covered, thus foreclosing CPB’s argument that the term “occurrence” includes contract-based claims. *Id.* As such, the fact that CPB’s product (chondroitin) was incorporated into Rexall’s nutritional tablets, thereby rendering its product useless, is immaterial as to whether the “occurrence” requirement was met.

In granting Nationwide’s motion for summary judgment and finding that it did not have a duty to defend or indemnify CPB for the underlying litigation, the court also reaffirmed the “gist of the action doctrine,” whereby courts determine whether the “gist” of an action sounds in contract or tort. *Id.* at *7. As Rexall’s claim alleged that CPB materially breached the parties’ contract by providing deficient

chondroitin, the court held that the distinction between damage to CPB's own product and damage to others' property caused by CPB's own product was irrelevant. *Id.* at *8. In other words, the fact that CPB's alleged breach caused consequential damages to Rexall's product does not change the fact that those damages arose by virtue of the contractual relationship. *See id.*

Importantly, the *CPB* decision reaffirms the general rule in many jurisdictions that breach of contract claims do not constitute an "occurrence" under CGL policies. Moreover, the court's affirmation and application of the "gist of the action doctrine" will serve to undermine attempts by creative plaintiffs to plead matters into coverage that clearly fall outside of coverage given the gist of the underlying action.

C. Number of Occurrences.

What would Orville Redenbacher Say? The New York Appellate Division Found Separate Occurrences Resulting from Exposure to Microwave Popcorn Butter Flavoring.

The issue before the court in *International Flavors & Fragrances, Inc. v. Royal Ins. Co. of America*, No. 605910/01, 677, 678, 2007 N.Y. App. Div. LEXIS 10935 (N.Y. App. Div. Oct. 30, 2007), was whether thirty separate personal injury claims constituted one "occurrence" or whether each claim constituted a separate "occurrence." *See International Flavors*, 2007 N.Y. App. Div. LEXIS 10935 at *1-3. International Flavors manufactured butter flavoring used in microwave popcorn and sold the flavoring to a microwave popcorn packaging company. *Id.* at *2-3. The claimants worked for the packaging company and asserted that the butter flavoring contained diacetyl and other volatile organic compounds, which upon their exposure to same, caused lung impairment and other respiratory injuries. *Id.*

International Flavors brought a declaratory judgment action against several of its insurers, seeking a determination of coverage with respect to a class action lawsuit filed by the injured claimants. *Id.* at *2. At issue was whether International Flavors would be required to satisfy the policies' self-insured retentions ("SIRs") in the amount of \$50,000 or \$100,000, and applicable on a per occurrence basis, for one occurrence or for thirty separate occurrences. *See id.* at *3.

The insurers argued that each claim constituted a separate occurrence, but International Flavors argued that: "... Exposure of the injured employees to the hazardous ingredients in [the] butter flavoring constitutes a single occurrence, without regard to the number of employees who were injured." *Id.* at *4. International Flavors argued that its repeated and continuous sale of butter flavoring over a number of years should be considered one occurrence. *Id.* at *12.

The court rejected International Flavors' argument, concluding that the sale and "shipment of butter flavoring . . . presented only the potential for injury; it was the exposure to diacetyl and other volatile compounds, though gradual and continuing over the course of years, that precipitated the actual harm, comprising the occasion giving rise to liability" *Id.* at *14. In reaching its conclusion, the court reasoned that: "Occurrence is not defined by the injury sustained but rather in terms of its

cause.” *Id.* at *8. Because thirty different people were continuously exposed to diacetyl on different occasions and extending over different time periods, the court held that there were thirty separate occurrences. *Id.* at *17

Under New York law, the court applied the “unfortunate-event standard.” A majority of courts apply the cause standard as opposed to the effect standard when addressing the number of occurrences issue. Though most courts apply the cause standard, as we have seen many times, the application of the same standard does not guarantee similar results. Rather, courts applying the cause test have rendered dramatically dissimilar decisions when ruling on comparable factual circumstances.

D. Exclusions:

1. Business Pursuits.

Some Like it Sweet. The U.S. District Court for North Dakota applied a Business Pursuits Exclusion to Deny Coverage for a Claim Arising out of Contaminated Corn Syrup.

In *Hueske v. State Farm Fire & Cas. Co.*, No. 1:06-cv-057, 2007 U.S. Dist. LEXIS 73405 (D.N.D. Oct. 1, 2007), Fred Berger and the Berger Cattle Company (collectively, “Berger”), in response to a shortage of cattle feed, began selling corn syrup to ranchers in North Dakota and South Dakota for use as a supplement to cattle feed. *Hueske*, 2007 U.S. Dist. LEXIS 73405 at *3-6. Berger arranged for Circle G Transport, LLC (“Circle G”), which also “back hauled” residual diesel fuel for a petroleum refinery, to deliver the corn syrup to the ranchers. *Id.* at 6-7. Kenneth and Kathleen Hueske (collectively, the “Hueskes”) received a load of corn syrup that had an “awful” and “sewer”-like smell. *Id.* at *7. The Hueskes’ cattle subsequently began to get sick, and some of the female cattle began aborting their calves. *Id.* The Hueskes tested the corn syrup, as well as tissue samples taken from the aborted calves, and discovered that the corn syrup was contaminated with diesel fuel. *Id.*

The Hueskes brought suit against Circle G and Berger, who was insured by State Farm under a Farm/Ranch policy and an umbrella policy. *Id.* State Farm initially defended Berger against the Hueskes’ suit under a reservation of rights, but then withdrew its defense once it determined there was no coverage. *Id.* at *2. Berger entered into a Miller-Shugart settlement and settled the Hueskes’ claims against him by confessing to a \$60,000 judgment and assigning his rights against State Farm to the Hueskes. *Id.* In the ensuing coverage action, the Hueskes sought a declaration that the policies covered their claims against Berger. *Id.*

The Farm/Ranch policy provided Berger with general liability coverage, but it contained a “business pursuits” exclusion. *Id.* at *11-12. The exclusion excluded coverage for property damage arising out of Berger’s business pursuits, and the court reasoned that a “business pursuit” is a continuous activity motivated by profit. *Id.* at *13. Because Berger sold several thousand tons of corn syrup to ranchers over the course of two years, the court concluded that Berger’s activities were continuous. *Id.* at *14-15. Similarly, because Berger testified that he intended to earn a profit by selling the corn syrup, the

court also concluded that Berger's activities were motivated by profit. *Id.* at *17-18. Accordingly, the court held that the business pursuits exclusion applied to the Hueskes' claims. *Id.*

The Hueskes, however, contended that two exceptions to the business pursuits exclusion applied. *Id.* at *18. First, the Hueskes argued that Berger's sale of corn syrup was an extension of his own ranching business, and therefore, was "ordinarily incidental to non-business pursuits." *Id.* at *19. The court disagreed with the Hueskes' position, reasoning that although the profits received from selling corn syrup lessened the expenses associated with Berger's own ranch, they were not incidental to Berger's ranch. *Id.* Second, the Hueskes argued that the farming exception to the business pursuits exclusion applied. *Id.* at *20. Although the policy did not define "farming," the court reasoned that the sale of thousands of tons of corn syrup as a supplement to cattle feed did not constitute "farming." *Id.* Accordingly, the court concluded that neither exception was applicable. *Id.*

The Hueskes also argued that the umbrella policy covered their claims against Berger. *Id.* at *20-21. However, the court agreed with State Farm, and found that the umbrella policy contained two exclusions that were "essentially the same" as exclusions contained in the Farm/Ranch policy, including the business pursuits exclusion. *Id.* at *22. As a result, the court concluded that the umbrella policy also did not cover the Hueskes' claim against Berger. *Id.*

Generally, the burden of applying an exclusion is carried by the insurer. The court in *Hueske* strictly applied the business pursuits exclusion and found that the insurer had satisfied all of the necessary elements.

2. Vermin Exclusion.

The Uncovered Rat Race. A Georgia Appellate Court Holds That the Vermin Exclusion Applies Only if the Vermin Infestation was Caused by a Different Exclusion.

On December 7, 2007, the Georgia Court of Appeals affirmed summary judgment against the insurer by finding that the vermin exclusion did not apply. *Ace American Ins. Co. v. Truitt Brothers, Inc.*, 2007 Ga. App. LEXIS 1295 (Ga. Ct. App. December 7, 2007). This action arose out of Truitt Brothers' storage of food products in a warehouse owned by Southland, the insured. *Truitt Brothers*, 2007 Ga. App. LEXIS 1295. Southland was found negligent in an underlying action by Truitt Brothers for allowing the rat infestation to occur from poor sanitation practices, and a judgment was entered. *Id.* Southland's insurer denied liability for the judgment under the vermin exclusion. *Id.* at *2.

The exclusion at issue provided that a loss caused by vermin is excluded "unless caused by a Covered Cause of Loss not excluded elsewhere" in the policy. *Id.* at *4. While the court disagreed with the trial court and found the exclusion to be unambiguous, the court affirmed summary judgment against the insurer because it found the exception to the vermin exclusion applicable. *Id.* at *3. It held that the effect of the exception is that losses caused by vermin are excluded "only if the vermin infestation was, in turn, caused by a different exclusion in the policy." *Id.* at *5. Thus, the court reasoned,

if the infestation were caused by a flood, the damage caused by the vermin would not be covered under the policy because it contained a separate flood exclusion. *Id.* As the record contained evidence that the infestation was caused by poor sanitation practices, and the insurer provided no evidence showing that a risk excluded in a separate provision of the policy caused the rat infestation, the court concluded that summary judgment was appropriate. *Id.*

The *Truitt Brothers* decision is significant in that it limits application of the vermin exclusion by essentially applying an exclusion within an exclusion. Thus, in any infestation scenario involving this exclusion, it is essential to establish the cause of infestation to determine whether it is excluded by another provision in the policy.

III. PROFESSIONAL LIABILITY COVERAGE ISSUES:

Bad Medicine. Coverage is Found by the Fourth Circuit Court of Appeals when Contaminated Medications Result in Injury and Death.

In *Pharmacists Mut. Ins. Co. v. Scyster*, 232 Fed. Appx. 217 (4th Cir. 2007), Urgent Care Pharmacy (“Urgent Care”) began producing methylprednisolone, a drug used to treat severe back and joint pain, after Upjohn pharmaceutical company stopped manufacturing the drug and certain physician’s offices inquired whether Urgent Care was able to compound the drug. *Scyster*, 232 Fed. Appx. at 219. When several patients in the physicians’ practices became sick with fungal meningitis, the South Carolina Board of Pharmacy initiated an investigation and discovered that the drug was contaminated with *wangiella dermatitidis*, a fungal mold linked to spinal meningitis. *Id.*

Pharmacists’ Mutual Insurance Company initiated a declaratory judgment action, seeking a determination that a professional liability policy issued to pharmacist R. Ken Mason, Jr. (“Mason”), who was Urgent Care’s pharmacist-in-charge, did not cover lawsuits filed against Mason by the injured patients. *Id.* at 220. The insurer first argued that because Mason violated the South Carolina Pharmacy Practice Act (“SCPPA”), coverage for the patients’ claims was excluded through application of a willful violation of law exclusion contained in the policy. *Id.* at 220-21. The Fourth Circuit disagreed with the insurer’s position, reasoning that a violation of law is not the same thing as a willful violation of the law. *Id.* at 221. Because the exclusion was not written to exclude all violations of the law, the court concluded that it did not apply. *Id.*

Next, the insurer also argued that the policy, which did not cover “manufacturing” of certain drugs, but which did cover compounding of medications, did not cover the damages allegedly caused by the contaminated methylprednisolone because Urgent Care “manufactured,” as opposed to compounded, the methylprednisolone. *Id.* After analyzing the policy language and the SCPPA, the court again disagreed with the insurer’s position, and concluded that Urgent Care had compounded the methylprednisolone. *Id.* at 222-25. As a result, the policy covered the injured patients’ claims against Mason. *Id.*

Finally, the insurer argued that the policy, which was in effect between June 19, 2002 and June 19, 2003, did not cover three patients' claims because although those three had fallen ill during the policy period, they had taken the contaminated methylprednisolone prior to the policy's effective date. *See id.* at 226. The Fourth Circuit also rejected this argument, applying South Carolina's modified continuous trigger theory, which applies to "claims based upon progressive damage that occurred during the policy period even if the actions causing the harm occurred before the policy took effect" *Id.* Because it was undisputed that all patients who received the contaminated methylprednisolone fell ill and suffered damages during the policy period, the policy covered the patients' claims. *Id.*

The *Scyster* decision emphasizes the critical nature of a policy's terms and conditions in regards to the examination of whether a claim falls within the scope of a policy's coverage or comes within the strict interpretation of a potentially applicable exclusion.

IV. CONCLUSION:

2008 will prove to be a most interesting year. As the recalls that have taken place over the past eighteen months make their way through the courts, we will likely see certain trends begin to develop. This area of evolving coverage issues will only grow over the next year. We will continue to monitor food contamination coverage cases and alert the industry to significant decisions and developing trends.

The views expressed in this paper do not necessarily represent the opinions of the authors or of any client of Cozen O'Connor.

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