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Baby Food Recall Covered Under Insurance Policy

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Insurance companies typically argue that a policyholder's liabilities arising out of a product recall are only covered, if at all, under a specialized product recall policy, and not under more widely purchased standard-form general liability policies. A recent federal court decision has rejected these arguments, and held that a general liability policy was triggered to defend an action against a policyholder alleging liability for incorporation of the policyholder's tainted ingredient into the claimant's finished product, resulting in a need to recall the finished product. *Thruway Produce, Inc. v. Massachusetts Bay Ins. Co.*, 6:11-CV-6337 EAW, 2015 U.S. Dist. LEXIS 94846 (W.D.N.Y. July 20, 2015).

The policyholder, Thruway Produce, had contracted to supply apples to Milnot Holding Company, to be used as ingredients in Beech-Nut baby food manufactured by Milnot. *Id.* at *3. Subsequently, Milnot discovered rodenticide mixed in with the apples supplied by Thruway (possibly the result of storage facilities used by Thruway disregarding the instruction not to use rodenticide). *Id.* at *3 & *21 n.7. Milnot sued Thruway, alleging "that [Thruway] had breached the supply contract and various express and implied warranties, and that Milnot had been forced to institute a product recall as a result of the alleged breaches." *Id.* at *5.

Thruway notified Massachusetts Bay Insurance Company of the action. Massachusetts Bay paid Thruway $50,000 pursuant to the limited product recall coverage available under an endorsement to the general liability policy it sold Thruway, but maintained there was no coverage under the higher limits of the general liability section of the policy. *Id.* at *6. Thruway and Massachusetts Bay cross-moved for summary judgment on Massachusetts Bay's obligation to defend and indemnify Thruway in connection with the underlying action brought by Milnot. *Id.* at *1-*2.

The *Thruway* court held the underlying allegations triggered Massachusetts Bay's duty to defend the underlying action. The court first held that the allegations in the underlying action alleged an "occurrence" causing "property damage," as required by the general liability coverage of the policies:

The term "occurrence" is broadly defined in the Policies to mean an "accident." As defined, the term encompasses the unexpected and unintended contamination of the apples that resulted in damage to the baby-food product, into which the apples were inextricably incorporated.

Id. at *20-*21.

The court rejected the insurance company's argument that a breach of contract or warranty cannot be an "occurrence," citing extensive New York authority for the proposition that "when an insured sells a product that the insured neither intended nor expected to be defective, and that product is incorporated into a third-party's product and proves defective, the resulting damage to the third-party's product arises out of an occurrence," regardless of whether the third-party proceeds against the policyholder under a breach of contract or tort theory. *Id.* at *27. The court then found that "the contaminated apples in this case caused damage to property other than the defective products themselves. The contamination caused damage to Milnot's baby food." *Id.* at *26. Therefore, the underlying action alleged an "occurrence."

The court also rejected the insurance company's argument that the underlying action alleged only "economic damages" and not "property damage." The court found that the allegations against the insured fell squarely within the policy's definition of "property damage":

In this case, as alleged in the underlying complaint, the contaminated apples were incorporated into Milnot's baby-food product, which became damaged thereby. Milnot incurred, among other items of loss, expenses related to the product recall and the destruction of the damaged product. Hence, the undisputed record establishes that the contaminated apples caused "property damage," i.e. "[p]hysical damage to tangible property, including all resulting loss of use of that property."

Id. at *29.

The court then held that none of the exclusions raised by the insurance company negated the duty to defend. An exclusion for "Recall of Products" did not preclude a duty to defend, because it excluded only recalls of the policyholder's own product, and it was the claimant's baby food, and not the apples the policyholder supplied, that were recalled. *Id.* at *33-*34. Similarly, exclusions for "Your Product" and "Your Work" did not apply, because the damage alleged was not to the policyholder's product or work (the apples) but to the finished product. *Id.* at *35-*36. An exclusion for "Impaired Property" extends only to property that can be restored by repair, removal, or replacement of the policyholder's work or product, and there was no "argument or evidence as to how baby food tainted with rat poison could be restored to use in any fashion." *Id.* at *36.

As a result, the court held that the insurance company had a duty to defend the underlying action as a matter of law. The court declined to address the motions on the duty to indemnify any underlying judgment or settlement, holding these to be premature pending further development of the actual damages proven in the underlying action. *Id.* at *38-*40. (While a full duty to defend is triggered if any of the allegations in the underlying action potentially fall within coverage, the duty to indemnify depends on the facts developed in the underlying litigation.) The court stated that it was possible that some types of damages alleged in the underlying action could fall outside of coverage or within one of the exclusions, but cautioned the insurance company that the New York Court of Appeals previously had indicated that many of the types of expenses sought in product recall cases fell within coverage. *See id*. at *39 and n.12 (citing *Thomas J. Lipton, Inc. v. Liberty Mut. Ins. Co.*, 314 N.E.2d 37 (1974)).

The *Thruway* decision reaffirms that, despite frequent insurance company arguments to the contrary, standard-form general liability coverage does extend to the defense and potential liability of a policyholder sued in connection with certain product recalls. An important factor is whether the policyholder's product is alleged to have caused damage to third-party property, including damage resulting from the incorporation of the policyholder's product as a component or ingredient of the finished product of another.