

# Client Alert

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## Suit Seeking Damages Arising from Food Product Potentially Contaminated by Tainted Instant Milk Is Covered Under Distributor's General Liability Insurance

In *Netherlands Ins. Co. v. Main Street Ingredients, LLC*, No. 0:11-cv-00533-DSD-FLN (D. Minn. Jan. 8, 2013), the United States District Court for the District of Minnesota held that an insurer owed coverage when its insured was sued by a customer alleging that the customer suffered loss resulting from the recall of a food product made with an ingredient allegedly contaminated with salmonella. The ingredient — instant milk — used as an ingredient in its product was itself the subject of a recall for the possible salmonella contamination. The court found that the inability to sell the end product amounted to “property damage” caused by an “occurrence” and that none of the policy’s exclusions applied.

### Background

Plainview Milk Products Cooperative (“Plainview”) sold milk to Main Street Ingredients, LLC (“MSI”). MSI resold that milk to Malt-O-Meal Company (“MOM”), where the milk was used as an ingredient in MOM’s manufacture of instant oatmeal. When the FDA discovered unsanitary conditions and salmonella at Plainview’s facilities, Plainview issued a recall of its milk and told its buyers to warn their customers of the recall.

Although none of MSI’s milk tested positive for salmonella, MSI forwarded the recall warning to MOM, which in turn issued a recall for its instant oatmeal. Then, MOM filed suit against MSI and Plainview for damages caused by the recall. That suit eventually settled. Before the settlement, MSI filed a claim for coverage with its insurer, Netherlands Insurance Company (“Netherlands”), seeking defense and indemnity in connection with MOM’s suit, under contracts for general liability insurance. Netherlands defended MSI in the MOM suit but reserved its right to deny coverage, and filed a declaratory judgment action.

### Summary Judgment

Netherlands sought a declaration that it had no duty to defend or indemnify MSI. MSI counterclaimed that Netherlands owed a defense and indemnification to MSI.

The Netherlands policy afforded coverage for “those sums that the insured becomes legally obligated to pay as damages because of bodily injury or ‘property damage’ to which this insurance applies.” Thus, the court concluded that for coverage to apply, MSI would be required to show that there was “an occurrence,” “that the loss was not known prior to the policy period” and that there was “property damage.”

The Netherlands policy defined an “occurrence” as “an accident ...” which, under Minnesota law, means “an unexpected, unforeseen, or undesigned happening or consequence from an unknown cause.”

Netherlands argued that the loss did not meet this definition because the loss arose from MSI's breach of its contractual warranty to provide a fit product. The court rejected the argument, finding that an "occurrence" can arise from a breach of contract as long as there is no intent to cause injury. The court further found that the record here showed no evidence of such an intent.

The court found that incorporation of the potentially contaminated milk into MOM's oatmeal constituted "property damage," even though the milk was not, in fact, contaminated. The court rejected the insurer's argument that there could be no "property damage" without actual contamination, and that the MOM recall was only precautionary and not based on any actual detection of salmonella. The court noted that, unlike other policies in which the definition of "property damage" required "direct physical loss," the Netherlands definition of property damage required only "physical injury." Physical injury occurred because the oatmeal was physically affected by instant milk manufactured under unsanitary conditions, and therefore subject to recall, even if the particular milk did not contain salmonella. The court further found that, under Minnesota law, the inability to lawfully distribute products because of FDA regulations is an impairment of function and value sufficient to support a finding of physical damage. Thus, the potential contamination that resulted in a recall was enough to constitute "property damage."

The court also rejected Netherlands' argument that the damages from the settlement, which included credits to customers, destroyed inventory and other costs, were not covered because they were "purely economic and not property damage." The court explained that the policy covered "not only property damage, but damages MSI must pay because of property damage." The court concluded that the settlement damages, which were because of covered "property damage," therefore were covered.

The court then addressed the exclusions raised by Netherlands. The court found the "your product" exclusion inapplicable because MSI did not seek coverage for damage to its milk, but rather, the claim concerned damage to MOM's oatmeal that was caused by the allegedly contaminated milk. The "impaired property" exclusion likewise did not apply because the oatmeal was found to have been damaged by inclusion of the milk.

Finally, the "recall" exclusion did not apply because MSI sought coverage "for damages from MOM's recall of the oatmeal" which, as the court determined in the context of the "your product" and "impaired property" exclusions, was not MSI's product or impaired property. Additionally, the court noted, recall exclusions have "no applicability when the claim is for property damage claimed to have been suffered by another property owner."

## **Implications**

Netherlands illustrates the significant coverage that may be available to policyholders whose business depends on the use and incorporation of ingredients and components supplied by others. The decision likewise underscores the important role general liability insurance plays for companies that manufacture and supply ingredients and products that are used in other areas of industry. Thus, where a defect or recall affecting "your product" occurs, coverage may still be available for liabilities tied to downstream injury or loss, despite any limitations that might exist for coverage to the product itself.

Netherlands also highlights the significance that policy wording can have on the availability of coverage. In Netherlands, for example, the court highlighted the distinction between two commonly used definitions of "property damage:" one requiring "direct physical loss" and the other requiring only "physical injury." The Netherlands policy contained the latter, which appears to have helped the court conclude that property damage had occurred even though the ingredient actually used in the product was not itself contaminated. This should serve as a reminder, therefore, that policyholders stay vigilant about reviewing their policies and being familiar with the policy language, rather than simply relying on their insurers, who might apply an overly restrictive construction without regard to the specific language in the policy.

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