

Court Finds Coverage for Consequential Damages Arising from Product Recall

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A Minnesota Federal District Court Judge recently ruled that the insured is entitled to defense and indemnification under its commercial liability policy for damages resulting from incorporation of its allegedly adulterated product into that of a customer. *Netherlands Insurance Co. v. Main Street Ingredients, LLC*, File No. CV-11-533 (D. Minn., January 8, 2013) (DSD/FLN). In *Main Street*, a cooperative sold milk to Main Street that was allegedly adulterated with salmonella, Main Street then incorporated it into an instant milk product it sold to Malt-O-Meal for use in Malt-O-Meal's product. The cooperative initiated a product recall at the request of the Food and Drug Administration (FDA), which included downstream purchasers and wholesalers of products containing that milk. Malt-O-Meal sued Main Street and the cooperative for recovery of damages in excess of \$1 million for destroyed inventory, credits, and fees to customers, and recalled freight. Netherlands Insurance Company (Netherlands) denied the claim and sued Main Street, seeking a declaration that: (1) there was no "occurrence" of property damage; (2) the claim was barred by the "known loss" doctrine; and (3) the claim was barred by various business risk and product recall exclusions.

With respect to "occurrence," the court noted that in Minnesota, an occurrence is defined as "an unexpected, unforeseen or undersigned happening or consequence from either a known or unknown cause." Netherlands argued that a breach of contract or warranty could never result in an "occurrence" as defined in the policy. The court disagreed, noting that "[c]ontractual liabilities arising from accidents, however, can constitute an occurrence." Regardless of how the claims were pled (i.e., in contractual or tort) the key question is whether the insured had "specific intent" to cause injury or otherwise engage in "conscience wrongdoing." The court found no evidence that Main Street had any knowledge at the time of sale that its instant milk product was potentially adulterated. For the same reason, the court also found that the "known loss" provision of the policy did not apply. Netherlands also argued that since Main Street's ingredient had never tested positive for salmonella, coverage for property damage was never triggered. The court disagreed, finding that the instant milk was "physically affected" since it had been manufactured in unsanitary conditions, and because it effectively could not be sold due to the FDA recall. Finally, the court ruled that various business risk exclusions such as those excluding damages to "your product" and "impaired property, and for "recall" were inapplicable because Malt-O-Meal had sought recovery of costs resulting from damage to its product, not the cost to repair, replace or recall Main Street's product.

This decision is welcome news for product manufacturers as it rejected the insurer's attempt to narrowly apply products liability insurance coverage to exclude claims simply because they were pled as "breach of contract" or "breach of warranty." The court properly recognized, consistent with existing Minnesota and other states' precedent, that the key questions are whether the underlying claim against the insured seeks covered damages and whether the insured knew of or intended those damages.

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