

Unpeeling The Layers Of Recall, Contamination Policies

Law360, New York (March 02, 2012, 1:28 PM ET) -- Experts speculated that the passage of the Food Safety Modernization Act in early January of 2011 would cause a surge in U.S. Food and Drug Administration (FDA) recalls of food products and a corresponding increase in demand for specialty insurance policies to counteract this increased risk.[1]

These predictions have proven spot on. While experts may disagree as to what caused the sharp increase in recalls, FDA data released in February shows there was a 50 percent increase in recalls for foods regulated by the FDA during the fourth quarter of last year when compared to the previous year.

During the final three months of 2011 alone, the FDA issued 176 food recalls by more than 150 companies. These numbers represented an 80 percent increase over the third quarter of 2011.[2] And this upward trend is likely to continue as the FDA and food companies increasingly take proactive measure to prevent consumers from getting sick.

This surge is statistically interesting, but more importantly for purposes of this article, it also highlights a significant issue for specialty recall and contamination insurers, policyholders and insurance brokers — namely, what risks have the insurer and policyholder negotiated to insure: recall, contamination or both.

Specialty policies do handle these risks differently, and failure to obtain recall coverage when there is only a suspected contamination may mean that a policyholder who mistakenly thought there was coverage is left uninsured.

Distinctions in Types of Specialty Insurance: Recall v. Contamination Policies

In light of the FDA's proactive measures, more and more often these terms are not synonymous; recall often no longer equates to contamination.

By way of example, there have been 44 recalls of food products so far this year. Of these recalls, however, almost two-thirds of their recall notices specifically state that no illnesses or adverse events have been reported to date in connection with this problem precipitating the recall.[3]

Where there is no illness, there is likely no contamination, and potentially no insurance coverage, depending on the risk that the insurer and policyholder negotiated to insure.

Product recall and contamination policies are specialized, customizable insurance policies, not standard Insurance Services Office Inc. forms. As a result, the terms of the policies can vary widely.

Accordingly, insurers and policyholder — and broker, if used — must expressly negotiate the terms. Many specialty insurance carriers provide varying levels of coverage: some cover only product recalls, others cover only actual contamination events and still others cover both.

Potential policyholders can also negotiate what losses they would like covered: first-party expenses, product replacement, loss of profits, third-party expenses, expenses incurred for rehabilitating the brand name and reputation, and/or incident response expenses. These distinctions can be significant, because the policyholder may experience a loss that has been eliminated from the scope of coverage during the negotiation of the policy terms.

Likewise, the policyholder or its broker might agree to an exclusion to reduce the premium that removes coverage for the policyholder's greatest risk. In each of these instances, the policyholder may argue that it reasonably expected coverage, only to find that the unambiguous terms of the policy state otherwise.

The Policyholder's Reasonable Expectations Should be Guided by the Terms of its Policy

When coverage is denied or limited based on policy terms, it is not necessarily the result of an overly technical reading of the policy, but a reflection of the operative policy's explicit and expressly bargained-for language. In that instance, these express terms inform the policyholder's reasonable expectation of coverage in the event of a FDA-recall or contamination event.

In most jurisdictions, the reasonable expectations doctrine is reserved for situations where the policy terms are ambiguous and open to more than one interpretation.[4] In that circumstance, a court may find that the policyholder had a reasonable expectation of coverage and construe the policy against the insurer.

But the doctrine does not protect policyholders who assumed that they had coverage for recalls when the plain and unambiguous language of the policy precludes coverage without actual contamination. In this situation, policyholders are stuck with the terms they bargained for.

The same is true where the insured has coverage for some expenses but chose to exclude others that ultimately prove to be the more costly expenses. In both of these scenarios, the policyholder has purchased the wrong coverage.

Conclusion

Food companies need to carefully evaluate their risk, which should include the risk that there is a recall without illness. Policyholder's initial relief that there is no illness among its customers may quickly turn into anxiety over a lack of coverage for recall expenses or lost profits.

The proactive approach of the FDA and a food company's retailers may result in a large amount of product being destroyed and significant costs to the food company, even without anyone actually getting sick.

Food recalls are increasing at a record-setting pace, and food companies and their brokers should have detailed discussions about the available specialty policies and the company's real risks. One-size-fits-all is not an option. There is specialty coverage available, but food companies need to find the coverage that fits their specific needs.

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[1] See, e.g., Nick Brown, Specialty Insurers May Thrive On New Food Regs, LAW360, Jan. 25, 2011; Jeff Casale, New Food Safety Law Adds to Recall Risks, BUSINESS INSURANCE, Jan. 9, 2011.

[2] See Dan Flynn, FDA-Regulated Food Recalls Surged in Last Quarter 2011: Undeclared allergens were leading cause of market withdrawals, FOOD SAFETY NEWS, Feb. 15, 2012.

[3] Recalls, Market Withdrawals, & Safety Alerts, U.S. FOOD AND DRUG ADMINISTRATION, www.fda.gov/Safety/Recalls/default.htm (posting 29 of 44 recall notices including this language).

[4] See 2 COUCH ON INS. §22:11 (2011)

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